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ECONOMICS

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ECONOMICS

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To

MY WIFE LILLIE

Who not only checked
English construction
in this book but
cheered me by saying
she thought it
interesting.

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Preface

The publication of a new textbook in economics may well seem to be an offense calling for some apology or excuse. The apology is hereby tendered, but the excuse is difficult to phrase convincingly. I realize that there are plenty of excellent texts and that the marginal utility of an additional unit will not be very high. Yet for several reasons I was impelled to write a book. It has become a convention or custom with the brotherhood to write texts, and I finally fell in with the tradition. This book illustrates well the compelling force of custom and convention. Also I wanted to organize my own ideas once, just to see what they would look like in a systematic treatise. And finally, I confess that to some extent I was impelled by the vulgar profit motive which has already done too much damage in academic circles. In extenuation of this last motive, and of my abandonment of the search for new truth for its own sake, I can only say that I have resisted the lure of lucre and the blandishments of the publishers for about thirty years.

I make no claim to originality in the fundamental economic doctrines elaborated in this book, and no claim that the book is complete or up to date in all respects. I have tried, however, to follow a plan which is more or less unique in the following respects:

1. I have emphasized the essential characteristics of capitalism at many points and have stressed the fact that, like all human institutions, it has been and is changing, that it has now been displaced in parts of the world, and that it may presently have to be abandoned, even in the United States, if its worst faults cannot be corrected. Capitalism is considered here in its historical development and in its relation to other economic systems. Much more than the usual attention has been given to the other isms, because some of the world is now living under other economic systems, because the same weaknesses in the capitalist order which brought its abandonment in some other countries are apparent also in the United States, and, finally, because a consideration of other economic systems throws much light on the operation of capitalism. I hope that the discussion of the Soviet system, for instance, will help students to see more clearly the function of prices in our economy.

2. In analyzing the capitalist system I have taken a rather critical attitude generally, on the theory that world developments over the past twenty-five years prove that our economic system is not in a sound condition, and that the maintenance of capitalism calls for critical diagnosis and corrective treatment, perhaps including a modest amount of surgery. The conclusion of the argument of much of the book is that nothing less can save our present economic system for a long time to come.

3. On the theory that most students are lacking in philosophical perspective, I have taken a rather broad philosophical attitude toward many economic questions. This is of course counter to the general drift in economics in recent years, but I believe it will prove more interesting and more useful to the majority of elementary students who do not expect to take further courses in economics. The intricacies of value analysis are not elaborated as fully as in a few recent works, partly because I believe there are limits to the amount of such analysis that elementary students can be expected to master, and partly on the theory that excessive emphasis on such analysis, with graphs and mathematical formulas, often gives students a false idea of the precision with which economic principles operate. I hope that even economics and business majors will gain a useful perspective from using this book, although they should of course have additional and more intensive work on value.

4. I have avoided heavy emphasis on facts and figures that will soon be out of date, in the belief that any material which will have to be relearned in two or three years is not worth learning now. *Aristotle's economic doctrines* seem to me more important than the figures of bank clearings for January, 1945, more likely to be the same three years from now, and therefore less likely to have to be revised.

5. The principle of relativity, stressed by Marshall in economics, and emphasized even more by philosophers and psychologists in recent years, is given more attention here than in most texts, because I believe that one of the important characteristics of an educated mind is the avoidance of absolutes.

6. I have tried to make economics as interesting as possible by stressing questions which I have found likely to rouse the students' interest. I have even ventured to hope that my book might be read by someone who did not have to read it; but perhaps that is wishful hoping.

My book is larger than I had intended, but I believe that its size is due to the fullness of some of my explanations rather than to the inclusion of an unusual amount of material to be learned. I really believe that for this reason the book will prove less difficult than some briefer texts. For courses which do not allow enough time to cover the entire book, some chapters can be omitted without breaking up the general scheme. Some teachers may wish to omit Chapters 2 to 7; others may find it wise or necessary to omit Parts VI and VII, and so organize the course along traditional lines. However, I believe that these two parts will prove interesting to students, will give a useful review of value theory, and will help to round out their understanding of our economic situation.

While I have worked about ten years on this book, I realize that I should have had more time to revise and check and polish; but my publishers have kindly extended the time limit so often that this time I am obliged to quit.

Grateful acknowledgments are due several colleagues and friends who have helped me. Professor Domenico Gagliardo read the first draft with meticulous care and offered many pertinent criticisms and suggestions; but since it was only the first draft that he read, and the manuscript has been almost completely rewritten, he should not be charged with any responsibility for such mistakes as appear in the book. Professor Lester Chandler of Amherst College read and checked the chapters on money and credit, banking and finance, also in the first draft; and my colleague, Professor Leland Pritchard, read the same chapters, to my great benefit. Professor Hilden Gibson read the chapters on the isms, caught a number of errors, and gave me many valuable suggestions. Professor A. Anton Friedrich read much of the manuscript and made many helpful suggestions. My wife checked all the chapters from the point of view of the English construction; my sister-in-law, Miss Inez Bernhard, read much of the manuscript and helped me to get the point of view of the student; and my son John, Jr., helped me plot some of the graphs in rough outline. Special acknowledgment is due Miss Dorothy Thompson, editor of Harper & Brothers. I owe her an extremely heavy debt of gratitude for her careful and amazingly perspicacious final reading of the manuscript. She found many errors that had escaped my own viligance, and helped immensely in getting the manuscript in final shape for the printers.

It has been difficult to find anyone to type the manuscript, and I should acknowledge the kind assistance of several typists, mostly past or present students of mine, who at some personal inconvenience have helped: Mrs. C. W. Hall, Miss Joyce Hahn, Miss Colleen Jones, and Miss May Wisner. Miss Margaret Adams and her staff, of the Stenographic Bureau of the University of Kansas, very kindly speeded up the work as much as possible.

JOHN ISE

PART I

INTRODUCTORY

Chapter 1.

Elementary Concepts

Definition and scope

Economics has been defined in different ways, but perhaps as good a definition as any is that of the great economist, Alfred Marshall: "Economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being." If this seems a bit nebulous, the student can turn to the table of contents to see some of the subjects that are covered. Since economics is a study of the *material* requisites of well-being, it is not much concerned with questions relating to morals, religion, ethics, or aesthetics; yet as far as such questions have economic significance, they may properly be given some consideration.

The study of morals, for instance, is likely to reveal the fact that many moral codes are also economic codes, worked out through long experience as good for the *material* advancement of man. The moral rules against cheating, deceit, and stealing are probably maintained largely because they encourage the building up of wealth. A society in which there was no public disapproval of or punishment for these practices would be poor in material goods. Lying is disapproved most strongly when it tends to waste time; in social affairs our best people lie a great deal—say that they have had a grand time when they have not, or that they hope we will come again when they hope we will forget where they live. Such lying does not mislead people to their detriment, but smooths out the rough spots along life's way, and is therefore not reprehensible. If, on the other hand, retailers were in the habit of lying to their customers about the goods they are selling, the retailing business could not be carried on as expeditiously as it now is, and with as general satisfaction to everyone concerned. Carver goes so far as to define sin in purely economic terms—as simply *waste.* Lying, cheating, stealing, murder, robbery—these are *wasteful* of human energies and therefore sin. We need not go quite so far as this to concede that moral and religious codes often have important economic implications, and perhaps economic bases.

Economics is sometimes criticized as a rather low and vulgar study, concerned as it is with only the "*material* requisites of well-being," and not at all with the "higher values" which are sometimes assumed to make a good life. The answer to this criticism is, in the first place, that in modern scientific study there must be some division of labor which becomes more intensive all the time, and that economics, restricted to the material side of life, has a wider field than even the ablest men can cover. All economists specialize in some branch of the science, and none can be thoroughly informed in all its branches.

In the second place, there is not always an antithesis between the material requisites and the so-called higher values; we do not always have to choose between the material things and the higher kinds of satisfaction but may need the material things as a foundation for the other. To some extent we do indeed choose. If people who have an abundance of material comforts receive an increase in income, they may choose whether to spend it for additional physical comforts—air conditioning, automatic furnaces, gadgets, or what not—or for things of intellectual or cultural significance—books, music, or artistic goods of some kind. Or, in apportioning their time, they perhaps choose between hours at a night club drinking material whisky and hours at a concert listening to immaterial Beethoven. That choice is open to them if they have enough income to spend; and they must choose.

Large numbers of people, however, even in relatively prosperous America, are too poor to afford the material comforts of life—healthful food, comfortable clothing and homes—and they cannot well build fine lives on a material basis inadequate to good health. The material comforts must usually be provided before people can indulge much in the higher cultural satisfactions, before they can easily be kind, generous, or perhaps even honest. The bearing of material plenty on moral qualities is generally underestimated.

Economics differs from the other social sciences partly in looking at problems from a different point of view. The study of religion is generally left to the preacher or sociologist, yet the psychologist may well study the psychology of religion, and the economist may discover that religion has important economic aspects. Max Weber found in the Protestant religion an important factor in the development of capitalism, and Karl Marx believed religion to be the "opiate of the people"—deadening their minds to injustice and bad economic conditions with the promise of heavenly rewards, and therefore constituting an obstacle to social progress.

Definitions

Goods may be wanted for mere survival, for health, for personal display, or for other reasons. By "goods" we mean *things that satisfy wants,* although economists sometimes distinguish between *material* goods and *immaterial* goods, the latter referring to *services* that satisfy wants, as for instance the services of cooks or barbers or great singers. In this book goods will usually refer to material things, although in some cases services may be included.

Some goods are necessary for life itself: air, water, food, and, in cold climates, some form of clothing and shelter. A very limited supply of the simplest goods is sufficient to sustain life. Prehistoric man had little more than the animals. He ate raw meat, wore animal skins —doubtless at first he wore no clothing at all —and lived in a cave, yet he survived. For comfort much more was required: cleaner, better-flavored, and more varied foods, clean and comfortable clothing, and a wide variety of other goods. A great multiplicity of goods —hundreds of commodities of every conceivable degree of complexity, and a wide variety of services—are required for a life of modern luxury.

Scarcity of goods

If there were plenty of all kinds of goods—enough to satisfy all wants without stint and without price—there would be no economic problems and no need for a science of economics. For that reason, as a wag once said, there will presumably be no need for economics, or for economists, in heaven. If all goods were available in unlimited quantities, there would be no quarrels about possession, no right of private property, no poverty, and no problems of labor or of the distribution of wealth. Money would not be needed, nor banks, nor savings institutions. The problems centering about value and price—the most fundamental problems in economics—would have no meaning. It is the *scarcity* of goods which gives rise to economic problems.

Following Carver in some respects, we may classify all things as shown in the diagram below.

Useless things do not concern us in economics—weeds, flies, poisonous snakes, waste from mines, ice at the South Pole. Such things satisfy no wants, are not desired, and offer no economic problem, unless it be the problem

- Things
  - Useless things
  - Useful things ("goods" or "wealth")
    - Free goods
    - Scarce goods ("economic goods")
      - Produced by nature (land)
      - Produced by man
        - Producers' goods (capital)
        - Consumers' goods

of their possible elimination. It is true that some such useless things may some day become useful, but for the present they are no concern of economics.

Useful goods, goods that satisfy wants, may be either free or scarce. Free goods are *those which nature provides in such abundance that they are available to all without stint and without price.* Air is such a good, although under pressure at the service station it is a scarce good. Sunshine is generally a free good; however, in densely populated sections of New York City it is a scarce good, and regulations are necessary to prevent the erection of buildings which would shut out too much of the available sunshine. Water in the streams and lakes of pioneer America was a free good, but under present conditions this is no longer true. Chicago is permitted to take only a limited amount of the scarce water of Lake Michigan. In every irrigated region water is definitely a scarce good, to be used in prescribed amounts, and paid for; and of course in every city water in a hydrant is a scarce good. Most of the land in America, although it is a gift of nature, has never been a free good. Even the Indians regarded it as a scarce good, the different tribes appropriating certain sections as their own hunting grounds. Wood is a free good in some Brazilian forests. The fish in the sea are usually a free good, but some fisheries are jealously guarded for the exclusive use of certain nations; the fish in our lakes and rivers, once free, are now scarce and may be caught only after purchasing a license. Similarly, game animals, once free, are now scarce and may be hunted only by license—even in most of Africa. There is a general tendency for free goods to become scarce as the population grows and as men appropriate more and more of the gifts of nature.

Goods are scarce which are available in such limited quantity that they cannot be appropriated without limit and without price. Such goods may be abundant, as for instance farm land or forests; but if they are so limited in supply that all who want them cannot be fully and freely supplied, they are said to be "scarce." Land is not rare, it is scarce; rattlesnakes are rare but not scarce in the economic sense.

The distinction between free goods and scarce goods is likely to convey a false impression to the student. Free goods are free only in the sense that they may be appropriated without payment, by all who want them and are willing to go to the trouble of finding and taking them; not in the sense that they are so generously supplied that they provide an abundant life for those to whom they are generally accessible. The free game that the pioneer ate was often hard to find and kill and was usually rather poor meat; catching fish required some time and effort; as a rule, the wild fruits and berries were not very plentiful, they were hard to pick and were on the whole inferior to the "scarce" fruits produced on modern fruit ranches. Free goods were generally secured at much greater cost, in time and energy, than the scarce goods of our present economy.

Why are most useful goods scarce? In the first place, nature is "niggardly" and does not provide most goods so generously that everyone can have enough without effort on his part. There is a limited amount of good land, and even when cultivated this will produce only a limited amount of crops; the yield can be increased by more intensive cultivation, but only within certain limits and never, in a well-populated country, to the point where there is plenty of free farm products for all. The amount of petroleum, coal, gold, silver, copper, iron, nickel, bauxite, and most other useful minerals is strictly limited, although the amount *brought to the market* can be increased within certain limits by devoting more labor and capital to mining. There is only a certain amount of standing timber growing and only a limited amount of land on which timber can be grown, although the amount of timber can be increased within certain limits. Water power is a limited resource, but more can be developed by building more hydroelectric dams. Nature imposes scarcity on us, particularly of the goods in whose provision she plays the most important part—most farm products, minerals, and lumber.

Some goods are scarce, not because of nature's niggardliness but because it *costs* something, in labor and in saving, to produce them. We shall consider labor cost first. Even the raw materials produced by nature must often be found, exploited, and worked over more or less before they are available for human use. Trees, for instance, must be cut, hauled to the lumber mill, sawed, planed, and hauled to the lumber yard and finally to the consumer, before they can be used; and the labor cost of these operations is much greater than the value of the standing timber. Some other products, such as handmade embroidery, handmade furniture, and paintings, owe their scarcity almost entirely to their labor cost, and most manufactured products are scarce, to a lesser extent, for the same reason. If labor were infinitely efficient and if all the workers enjoyed working to the full extent of their capacities, there would be only such scarcity of hand embroidery and handmade furniture as is imposed by nature's limitations on the raw materials used, and practically all products would be much cheaper than they are. But there is a limit to the labor power of any community or nation, and work is more or less distasteful to most people. There is therefore a psychological cost of production which limits the supply of most goods.

Another cost is involved in the production of almost all goods—the cost of the *saving* necessary to create the capital used. Vast amounts of capital in the form of factory buildings and machines are used in the production of all but handmade goods, and this capital is the result of saving, by which we mean keeping consumption (destruction of utilities) below production (creation of utilities). If people generally did not care much about consuming but enjoyed saving instead, there would be more saving, more capital, and therefore more goods produced. The cost, sacrifice, self-denial involved in foregoing consumption and saving instead, is thus one of the reasons for scarcity.

Some economists include only scarce goods under wealth, because economics is usually concerned only with scarce goods; but for most purposes it seems better to define wealth as including free as well as scarce goods. Otherwise we are faced with a paradox: if we could make certain scarce goods so plentiful that they would be free, we should thus reduce the amount of wealth, while if we could make some of our free goods scarce we should increase it.

Public goods

Public goods are economic goods that are supplied free to the public, although produced at a cost to the public and therefore properly classified as scarce. Such goods include parks, museums, hospitals, streets, highways, bridges, and public schoolhouses. On the whole, the amount of public goods tends to increase as a keener social consciousness develops. Socialists picture a future society in which many goods now privately owned will be free to the public.

Capitalism and the apportionment and production of goods

Since there are not enough of the scarce goods to supply all our wants freely, some way must be found to apportion them among the people who want them, and to set people at work to produce goods. This may be done in any one of three ways. In the first place, an autocratic dictator might apportion the goods and order the people to work, somewhat as the Pharaohs of Egypt and the Incas of Peru did in ancient times. In the second place, as advocated by socialists, the apportionment might be made and the production managed by a democratically elected government, with everyone sharing the goods equally or according to need, or perhaps with people of assumed merit receiving more than the others.

Apportionment and production of goods may be managed, in the third place, not by any government agency, but through the operation of what may be called private capitalism (in its simpler form). This allows each one to get what he directly produces or can exchange his product for in the market; and it protects his ownership through the institution known as private property, which we may define as *the right of individuals to exclusive control over valuable things.* We see this system at work in farming today, in a fairly simple form. Each farmer owns whatever he produces, or whatever he can exchange his product for, and the government protects him in his ownership.

Commons has defined capitalism, as distinguished from the feudalism out of which it developed, as "production for the use of others and acquisition for the use of self."[1] In a capitalist system the amount of goods any man acquires is determined by the exchange value of his own product, the exchange being made through the use of money. To the extent that such a society is competitive, the amount of goods and services apportioned to each member is determined by his contribution to the general stock or flow of goods. The government has nothing to do with it, except that it may formulate rules to prevent monopoly and unfair practices. Everyone is free to produce and sell in the market any goods or services that he believes others will pay for—wheat, cotton, hogs, shoes, clothing, medical services, legal services, education, music, or other entertainment. If he produces a quantity that others will pay well for, he will gain in money and in goods which, under the institution of private property, will be his own exclusively. If, on the other hand, he produces goods or services that no one will pay much for, or if he produces only a small quantity, he will have little money and few goods and services—he will be a poor man. Here, theoretically, we have a scheme not only for apportioning the available goods and services but for stimulating industry and enterprise and for increasing the supply of the kinds of goods and services most wanted.

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[1] John R. Commons, *Legal Foundations of Capitalism,* p. 21.

Capitalism and freedom

Thus in a capitalist society, to the extent that it is competitive, every individual is permitted to choose his own work, to sell as much of his goods or services as he can, for any price he thinks he can get from the public, and so to make as large profits as competition will permit. Under such a scheme, the only way an individual can prosper, in theory, is to serve society well. Serving his own interests, he is led by an "invisible hand" to serve the interests of society, as Adam Smith once said. At the same time he is free from any dictation except that of the public to whom he is obliged to sell, and he has no just complaint if the public does not want his product. The public has a right to its own wants and desires, reasonable or unreasonable, and everyone must adjust his own production accordingly as well as he can. Thus, to the extent that it is competitive, this economic system—which we call capitalism, in its simpler form—appears to provide freedom and justice. A later chapter will show that modern capitalism is not so simple as this, that it is by no means entirely competitive, and that therefore it does not always provide freedom and justice.

Capitalism materialistic in spirit

Capitalism naturally lays heavy emphasis on the production of goods and on the business shrewdness needed therefor and in the gaining of wealth. The shrewd businessman earns the great fortune; he is the one who can afford the fine house, the yacht, the oriental rugs; his is the power, the honor, and the glory. To the extent that his rewards are earned fairly, however, this seems not unfair or necessarily unwise. If a brewer competing with other brewers is able to make millions of dollars, while a great mathematician like Einstein may earn only a modest salary, it indicates not merely that society prefers beer to mathematics, although it might indeed have some such preference, but that society rates the brewer's contribution as more important. The mathematician has no right to complain. He studied mathematics with full knowledge of the fact that society rewards successful brewers far better than famous mathematicians. Although it is a question whether we do not overemphasize business sagacity and productive capacity in a material sense and give too little honor to the intangible contributions that American civilization seems to lack, as long as we retain capitalism we must build our civilization around the businessman—or perhaps let him build it for us.

Capitalism and acquisitiveness

Capitalism is thus a scheme for hitching self-interest to public service. The system rests implicitly on the assumption not that men are moved only by selfish motives, but that selfish motives are more dependable than other motives and that the only way to get most men to work hard and consistently is to appeal to their cupidity. As Marshall puts it: "History in general, and especially the history of socialistic ventures, shows that ordinary men are seldom capable of pure ideal altruism for any considerable time together."[2] Defenders of the capitalist system assume that this human selfishness is natural, hereditary, and largely unchangeable; they differ in this respect from the socialists, who think that it is the result of training and environment, and could be changed.

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[2] Alfred Marshall, *Principles of Economics*, p. 9.

The purpose of economic activity under capitalism is acquisition, more specifically acquisition in terms of money—"making money," in common parlance. This idea of "making money" is rather new in history, in contrast with the idea of earning a livelihood which was characteristic of the feudal handicraft economy. Aristotle, it is true, railed against those Greeks who "turn every quality or act into a means of making money"; Plato considered a disposition to "unbounded acquisition of wealth" a real danger to his Republic; Rome had her wealthy and avaricious publicans who exploited the provinces and her own people to build up great fortunes; money lenders and capitalists of the Middle Ages built up considerable fortunes; princes in India have hoarded vast fortunes in the precious metals—fortunes that are perhaps comparable to those of our wealthiest Americans. None of these, however, represent capitalist "money-making." The accumulations of wealth in antiquity and medieval times were made largely in the form of jewels, money, land, or in some cases royal monopolies or concessions. There was nothing like the great stock and bond accumulations of our present-day capitalists, which seem to pile up almost limitlessly.

Under feudalism land was the dominant factor of production, the main form of wealth, the ownership of which gave social prestige and political power. Under capitalism land is relatively unimportant; while capital, man-made productive wealth in the form of factories, railroads, engines, warehouses, office buildings, is vastly more abundant and more important. From the observation tower of the Empire State Building in New York City a man might see spread before his eyes perhaps as much capital as there was in the whole continent of Europe at the time of Charlemagne; and such men as Ford, du Pont, and Rockefeller, the owners of much of this capital, represent what some economists call the "ruling class" in our capitalist economy.

The four divisions of economics

Economists often divide the field of economics into four subfields—production, exchange, consumption, and distribution. This division will be followed here, not because it meets all the needs of logical classification and analysis but because it is both widely used and about as good as any. In economics as in many other studies, the ideal procedure would be for the student to learn everything at once, since each part is needed for the understanding of every other part; but inasmuch as this is impossible we shall begin with production, because production comes first in the actual world, and because it is more concrete and perhaps simpler than the other three divisions.

1. *Production.* In the discussion of production we shall consider not only the "making" or "manufacturing" of goods, but *all activities which result in the creation of utilities,* utility being defined as *the power to satisfy wants.* Man cannot create material things; he can only create utilities. The farmer plants seeds in the ground and raises wheat, creating what may be called *elementary utility;* the miller grinds the wheat into flour and the baker converts it into bread, creating *form utility;* the delivery truckman hauls the bread to the retailer, adding *place utility;* and the retailer holds it until it is wanted, adding *time utility.* A fifth kind of utility, *possession utility,* may be afforded by business agencies which merely arrange purchases or trades. A house or farm may be of greater value to one man than to another, and the real estate agency which arranges a purchase or trade provides this utility.

Four factors of production are used in the productive process: land, capital, labor, and the entrepreneur. *Land,* defined as *the gifts of nature,* includes not only the surface of the soil but everything below and above the surface that is provided by nature. The term as it is used in economics thus includes farm land, forest land, urban sites, mineral resources, rivers, lakes and oceans, water power, rain, sunshine, winds and climate, virgin timber, and all wild game—everything provided by nature. *Capital,* defined as *the man-made goods used not for the direct satisfaction of wants but for the production of other goods,* or, more briefly, as *the man-made instruments of production,* includes such things as factories, machines in the factories, plows on the farm, and the housewives' sewing machines. *Labor* is defined as *any exertion of mind or body undergone partly or wholly with a view to some good other than the pleasure derived directly from the exertion itself.* This definition indicates the difference between work and play, the latter being activity engaged in for its own sake.

In the modern capitalist system, land, labor, and capital do not of themselves produce anything; they must be combined, organized in a productive enterprise, and "managed." The fourth factor of production is the *entrepreneur.* In a simple form of business, such as farming, the entrepreneur may be also landowner, laborer, and capitalist; even in a larger and more complicated business, the entrepreneur may own his land and capital, but he will ordinarily have to use some labor in addition to his own. Most economic analyses proceed on the assumption that businesses are managed by individual entrepreneurs, an assumption which is valid for the vast numerical majority of enterprises, such as farms and retail shops, but not valid with respect to the greater absolute amount of "big business," in which the corporation is the almost universal form of business organization.

2. *Exchange.* Since nearly everyone is producing for the use of others, his output has to be "exchanged" for the goods of others before he can consume. Here we encounter the process of *exchange,* the second division of economics, and the various agencies that make exchanges—retailers, wholesalers, commission men, brokers, advertisers, and salesmen. Since exchanges are made through the use of money or credit, we must also study money and banking; and since *values*—the *ratios at which goods exchange*—are fundamentally important factors in determining the apportionment of goods, we must consider them carefully. It may be observed that exchange is to some extent a part of production, for those engaged in exchanging goods are truly producers in the sense that they are creating utilities; but it will be well to consider exchange separately. We must give particular attention to the laws governing values or prices, which are the central core of economic science.

3. *Consumption.* The end and purpose of production is of course consumption, which we may define as *the destruction of utilities in the satisfaction of human wants.* This consumption, or destruction, may take place in an instant or over a period of a hundred years or more. The gasoline used in an automobile explodes in a fraction of a second and is "consumed." The coffee at the breakfast table lasts a few minutes, the after-dinner cigar perhaps a half hour, the wood in the fireplace an hour or two. Shoes may by reason of great strength last a year, watches twenty years; period furniture may be handed down from generation to generation, and century-old houses are still in use. All of them are ultimately worn out or they pass out of style; their utilities have been "shed" or destroyed, they have been *consumed.*

4. *Distribution.* When the goods produced have found their way to consumers and have rendered their utility, there is still a fourth field of economics—the distribution of wealth and income. Distribution may be either *functional,* that is, it may involve the apportionment of the wealth or income among the four factors of production—land, labor, capital, and entrepreneur—as rent, wages, interest, and profits respectively; or it may be *personal,* involving the apportionment of the wealth or income among individuals or families. In studying functional distribution we analyze the laws governing the rates of rent, wages, interest, and profits; and in studying personal distribution we consider the reasons for inequalities of wealth and income and some of the problems arising out of such inequalities.

The "isms"

Finally we shall take up the economic systems alternative to capitalism, the "isms"—socialism, communism, and Fascism. This seems wise, not only because many of the peoples of the world are now living under one or another of these systems, but because there is some evidence that our own economy is drifting toward some form of "collectivism," either socialism or Fascism. Since these terms are used occasionally throughout the book, they are defined here. By socialism we mean *the public ownership and operation of the socially important industries, under a democratic form of government.* Communism is difficult to define for various reasons, but its underlying theory is somewhat the same as that of socialism, except that communists believe that their ends can be achieved only by a *violent revolution* and that, for a time at least, government must assume the form of a *dictatorship*. Communism also probably involves more government ownership and control than most socialists would approve. Fascism has been defined in various ways. Like communism it calls for a *dictatorship,* but unlike communism it permits *private ownership of business concerns,* at least in theory. In both Italy and Germany it achieved power partly through the help of business interests. It is strongly *militaristic* in spirit.

Economics a difficult study

The student should steel himself to the fact that the study of economics will be difficult in some respects. This is true, in the first place, because some of the important terms used in economics—for example, land, capital, production, demand, supply, value, scarcity—are borrowed from the ordinary business vocabulary but are given new, quite different, and in some cases technical meanings. Even when the student has learned the economic definitions of such terms, he finds it easy to slip back to the accustomed meanings.

In the second place, different economists may use the same terms in different senses. This is unfortunate, of course; but, as in the case of the weather, no one has ever done anything about it. Moreover, economists sometimes differ not only in their use of terms but in their attitudes on some of the most important economic questions. Some economists are sympathetic to labor unions, others are somewhat critical; some regard men of wealth with great respect, others are inclined to criticize their ideals; some think of economic inequality as the cancer of modern capitalist society, the greatest threat to its stability, while others regard it as inevitable—since the poor are unworthy and have such "pore ways"—or even good; some economists appear to believe that civilized life can exist only under capitalism, while others hanker for socialism. The fact that economists differ thus is sometimes advanced as evidence that they do not really know much about their own business; but this conclusion is not justified. They probably do about as well as the experts in any of the other difficult and elusive "social sciences." Like all people, economists differ in their social attitudes, sympathies, and ideals; and therefore they differ in their views and opinions on questions in which these personal qualities play an important part.

Perhaps the most serious difficulty in the study of economics, and an even more definite difficulty in the *teaching* of economics, is the fact that the subject deals with problems in which powerful economic interests are involved, in which therefore any views expressed are likely to arouse the passions and prejudices of one economic class or another. Economists who opposed the tariff were once subjected to bitter criticism from protected interests, and today the impartial study of such problems as labor organization, taxation, economic inequality, and the "isms" is fraught with danger. Such problems cannot be evaded, yet many economists have lost their jobs because they expressed "wrong" opinions regarding them. In this book the author will try merely to present the various possible views on highly controversial questions and leave the student to formulate his own opinions, hoping that he will do this cautiously and with an open mind —which does not mean timidly and with a vacant mind.

QUESTIONS

1. List ten important questions of the day. Which of these are essentially economic questions? How many of them directly or indirectly involve economic matters?
2. Why are most of the things you want more or less scarce? What do you mean by "scarce"? The two big broadcasting companies have made about 90 per cent on their investment, through their control of the "air" for broadcasting. Is the air for this purpose "scarce"? If a corporation were given a monopoly of the privilege of breathing air and charged $10 a year for the privilege of breathing, would air be scarce?

3. Since pioneer days many free goods have become scarce goods. Why? Do we live less well now that these goods are scarce? Why or why not?
4. Carver says that economic scarcity leads to conflict (a) between man and nature, (b) between man and man, and (c) among the various interests or desires of the individual. Illustrate each type of conflict. Is a war like World War II an illustration of one of these?
5. Suppose that lumber and labor worth $1000 are used in making furniture that is worth only $1000; is that production? Which of the following represent consumption: a cook spilling the soup on the floor, a man drinking beer that he does not like, a pyromaniac setting fire to his garage to enjoy the fire?
6. What do you mean by "land," "labor," and "capital" in economics? Does the meaning of these terms in economics differ from their meaning in ordinary usage?
7. Define wealth. Distinguish wealth from capital. Which of the following are wealth: a gold dollar, a paper dollar, an automobile that costs more than you get out of it, a pagan temple, an education, personal skill, the moon, a railroad franchise, the air in a hothouse, the free air you get at the service station, a mortgage, a U. S. bond, fish in the ocean, gold in a mine, natural teeth, artificial teeth, health? Which of the above are capital?
8. Is a reasonable amount of wealth generally essential to the development of kindness and generosity? Why?
9. May a good be capital and also to some extent a consumers' good? Give an illustration.
10. "Capitalism is a scheme for hitching self-interest to public service." Explain. Does the desire for gain often lead to the production of shabby products, in literature, painting, and music, for instance?
11. In what way does competition differ from the struggle for existence among brutes?
12. Why do we need the institution of private property? Why did some of the American Indians have no private property in land? Why do we not allow it in city, state, or national parks, or in the public schools or churches? In what economic areas have private ownership and activity been superseded by government ownership and activity? What is the reason for this trend away from private ownership?
13. If men can make money only by producing goods or providing useful services for others, why do we need a government?
14. Carver says that moral codes are based on economics, that moral conduct is that which tends to make the social group survive and prosper. Would this principle justify the moral code against deceit, stealing, excessive drinking? Mention some instances in which the ideal of increasing wealth might conflict with other ideals.
15. Distinguish clearly between good and bad men, high and low wants, high and low motives, culture and vulgarity, beauty and ugliness, production and destruction, work and play, progress and retrogression, waste and conservation, natural and artificial. Are all concepts relative?
16. What is the difference between a selfish and a benevolent person? Is a selfish person less valuable to society than a benevolent person? Who did more for the people of the United States, Cornelius Vanderbilt (who said, "The public be damned," and built the New York Central) or the millionaire who gave all his money to the church?
17. If the potato crop of a communistic society which had no commerce with other communities were to fall off one-half, how would they regulate the consumption of potatoes for the following year? How is it done under a capitalist order?
18. Why may it be better to include free goods in the concept of wealth?
19. Some economists are somewhat favorable to socialism, others are very hostile to it. How can men of scientific training differ in this way? The Supreme Court often decides important questions by a vote of five to four. Do not the justices know the law?

Part II

PRODUCTION

Chapter 2.

The Laws of Production

The concept of production

Production has already been defined as the creation of utilities—elementary, form, place, time, and possession utilities—and this definition covers most forms of legitimate economic activities, even those which do not result in tangible goods, for production may afford utility directly. The violinist is as truly a producer as the man who makes the violin, the actor is as truly a producer as the carpenter who helps build the theater. With the rapid development of labor-saving machinery and the consequent reduction in the number of laborers needed to produce a given amount of material goods, a growing proportion of the people are engaged in providing *services* of various kinds. Among these are doctors, dentists, nurses, entertainers, teachers, investigators, lawyers, salesmen, accountants, statisticians, and a thousand other types of workers.[1]

Productive vs. unproductive labor

If the total output of goods and services in a given society is to be at its maximum, all labor should be *productively* employed; in fact, one of the important functions of the government is to encourage productive labor and discourage unproductive labor. But the distinction between these cannot be drawn precisely. Certain false notions on the subject can indeed be dismissed with only a brief discussion. Occasionally we hear it suggested that agriculture is a particularly productive and meritorious occupation, whereas retailing is largely parasitic, a way of taking toll from the real producers, the farmers. This goes back to Aristotle, and was old in his time. Aristotle considered livestock breeding, husbandry, fishing, hunting, and *apparently even piracy* as natural and honorable occupations, whereas trade was "a mode by which men gain from one another," and so was "unnatural." This notion dominated the thinking of Roman writers and philosophers—Cicero, Cato, and Seneca, for instance—reappeared in the writings of the physiocrats and even of Adam Smith, and we see traces of it today in the tradition of the British aristocracy that noblemen should generally own land.

Another economic fallacy, perhaps related to the fallacy that farming is the most "productive" of all occupations, holds that the only productive labor is that which creates *tangible* wealth. According to Adam Smith, the work of menial servants "consists in services which perish generally in the very instant of their [illegible] formance, and does not fix or realize its[illegible] any vendible commodity which can rep[illegible] the value of their wages and maintenance." Even the great Alfred Marshall takes this point of view, although he sees that other points of view may be valid, and warns us that the wor[illegible] "productive" is a "slippery term" whi[illegible] in not be used where precision is ne[illegible] by the shall himself defines it to mean "productive of the means of production and of durable sources of enjoyment," thus excluding services which have no tendency to build up material wealth.

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[1] See *American Economic Review*, June, 1930, p. 231.

Altogether, Marshall's theory that productive labor must create "the means of production and of durable sources of enjoyment" appears to stress material things far too much. The end and purpose of economic activity is presumably the satisfaction of wants, and material things are very important; but they are not all-important. A philosopher looking at America today might well wonder whether the American people have really found a satisfactory life, for all their material things. Americans of the upper and middle classes have indeed satisfied material wants rather fully; they are well fed, well housed, and they have many material gadgets with which to keep themselves physically comfortable; but not many of them have the capacity to enjoy the riches of good literature, music, or art. There may be poverty of wants as well as poverty of goods. Some of the courses in American colleges—Greek, Latin, philosophy, economics, sociology, history, political science, and the fine arts—probably tend to divert the attention of the students from the production of material wealth; yet they may add to the students' lives something more highly valued than additional material wealth. It is the almost unanimous opinion of college graduates later in life that this is true. It should not even be too readily conceded that such studies do not contribute to the production of material wealth. To some extent they help to develop the civic intelligence necessary to the successful operation of capitalist democracy, and so they may contribute heavily to the production of material wealth. One of the reasons why rway, Sweden, and Denmark have been to make their economic systems work so is that their people have a very high level economic and political intelligence.

Some goods satisfy immediate wants but in the long run may be injurious to health or character and so reduce the total of satisfac- [illegible] other goods may bring long-run as well as immediate satisfaction. Cocaine, opium, for some people whisky, may satisfy a very intense present want but in the long run bring net unhappiness; food, healthful clothing and houses, good books, good music, really artistic pictures satisfy our wants immediately and also do us permanent good, or at any rate no harm. Is the labor used in providing the first class of goods to be considered "unproductive" and the labor used in providing the second to be called "productive"? The distinction is real, and for some purposes important, but it is not one with which economics is much concerned. If we concede that opium and whisky bring, in general and in the long run, more unhappiness than happiness, more disutility than utility, what shall we say of wines, beer, ale, tobacco, coffee, Coca-Cola, or candy? Viewing the rotund contours and double chins of many well-to-do Americans, we might easily conclude that roast pork and gravy and mince pie and candy are more harmful than tobacco. Tobacco tends to shorten life; but some men and women, like Mark Twain, might wonder whether it is worth while to live longer without tobacco. If the economist were to try to ascertain the total long-run effect of various goods on human happiness, he would doubtless do the job indifferently and would get nothing else done.

History of production

Early primitive man doubtless "made" or "manufactured" little himself, but merely appropriated what nature provided—fish, game, and wild fruits. Slowly, through the centuries, however, he learned to work over the products of nature more and more, to make fishhooks from bones, to make spears, bows, and arrows from trees, mallets from stones, clothing from hides. Such production was carried on by the labor of man alone, and on a very small scale. Later, animals were tamed and used in certain operations, especially in carrying burdens and in cultivating the soil, and this increase in the power at man's disposal caused a great expansion of production. Much later still, various natural forces were harnessed to production—wind, water power, steam, and in very recent years the explosive power of gases, as in the automobile and tractor. At the present time it is estimated that the United States has available more than a billion horsepower of energy.

With the development of new sources of power came development of machines. As long as man had to rely on his own muscular powers, tools were necessarily small and at first simple—bone, stone, or bronze spearheads, hammers, and knives. Much later came the development of more complicated machines for spinning and weaving, but they still were so small that a man could operate them. In some cases, within the period known to history, the muscular powers of many men were coordinated to accomplish certain tasks, as in the galleys propelled by slaves, and in various war weapons, such as the battering ram. The building of some of the ancient monuments, such as the pyramids of Egypt and the temples of Baalbec, must have required an extraordinary coordination of the puny muscular powers of men.

The use of animal power led to larger tools, such as the primitive plow, the sled, the wagon, and the war chariot; and the later use of natural powers of water, wind, and steam gave great impetus to the development of machines of vast size and complexity. Power made it possible to duplicate machines indefinitely and the factory came into being, with a huge increase in production.

Along with the increase in machines and power, and essential to modern productive processes, came the rapid development of the scientific method and of such particular sciences as mathematics, physics, chemistry, metallurgy, electromagnetism, thermodynamics—a hundred specialized sciences of direct use in machine production—and somewhat later the rise of the biological sciences, which have greatly increased production in other areas, as for instance agriculture, and have done so much to improve the health of the people and so to increase production. The gradual acceptance of the scientific attitude was itself a historical fact of the greatest importance, for as long as superstition and mythology dominated men's thought about natural processes there could be little scientific or technological advance. Many of Leonardo da Vinci's discoveries in mechanics, biology, and natural history did not see the light of day until about two centuries after his death. As the machine technology advanced, science was called upon more and more to outline the principles upon which mechanical and chemical processes depend; and today the part of scientists and engineers in production is quite as important, if not as obvious, as that of workmen and entrepreneurs in the plants.

So great has been the increase in productive efficiency that in the United States the problem of production is on the way to a fairly satisfactory solution. If we could make our economic system work steadily and efficiently, if some of the most obvious wastes could be eliminated, and if income and goods could be more equally distributed, our present productive powers would be adequate to provide a modest yet fairly good life for nearly everyone. In the study of economics today, our main emphasis should be not on the task of perfecting our productive equipment, but rather on the problem of keeping what we have in full and steady operation, securing a better distribution of wealth and income, and providing greater security for all.

Changing distribution of productive labor

This vast growth in production has brought a marked change in the distribution of labor among the various productive industries and functions; this is shown by Fig. 1. Viewed broadly, this chart shows that we are devoting a decreasing proportion of our labor to the production of necessities, and an increasing proportion to providing luxury goods and services of a type that we once could not afford. The most important change indicated is of course the declining relative significance of agriculture. In the comparatively poor and unproductive economy of 1870, a fairly large proportion of the workers were producing the mere essentials of life—food, and the cotton and wool needed for clothing. With the simple farm equipment of the time, many workers had to devote themselves to farm production, for food and clothing are the first essentials of life. As the productivity of farm machinery increased, a smaller and smaller proportion of the workers were needed to produce these essentials, and more labor shifted to the production of comfort and luxury goods and services. More labor went into professional work, into medicine, nursing, dentistry, teaching; public service employment increased considerably in the various social services provided by the government; employment in mining increased, largely in the extraction of petroleum; manufacturing called for a growing share of the labor as we added to our flood of comfort and luxury goods bicycles, bathtubs and running water, furnaces, electric lights, comfortable homes, refrigerators, automobiles, and radios.

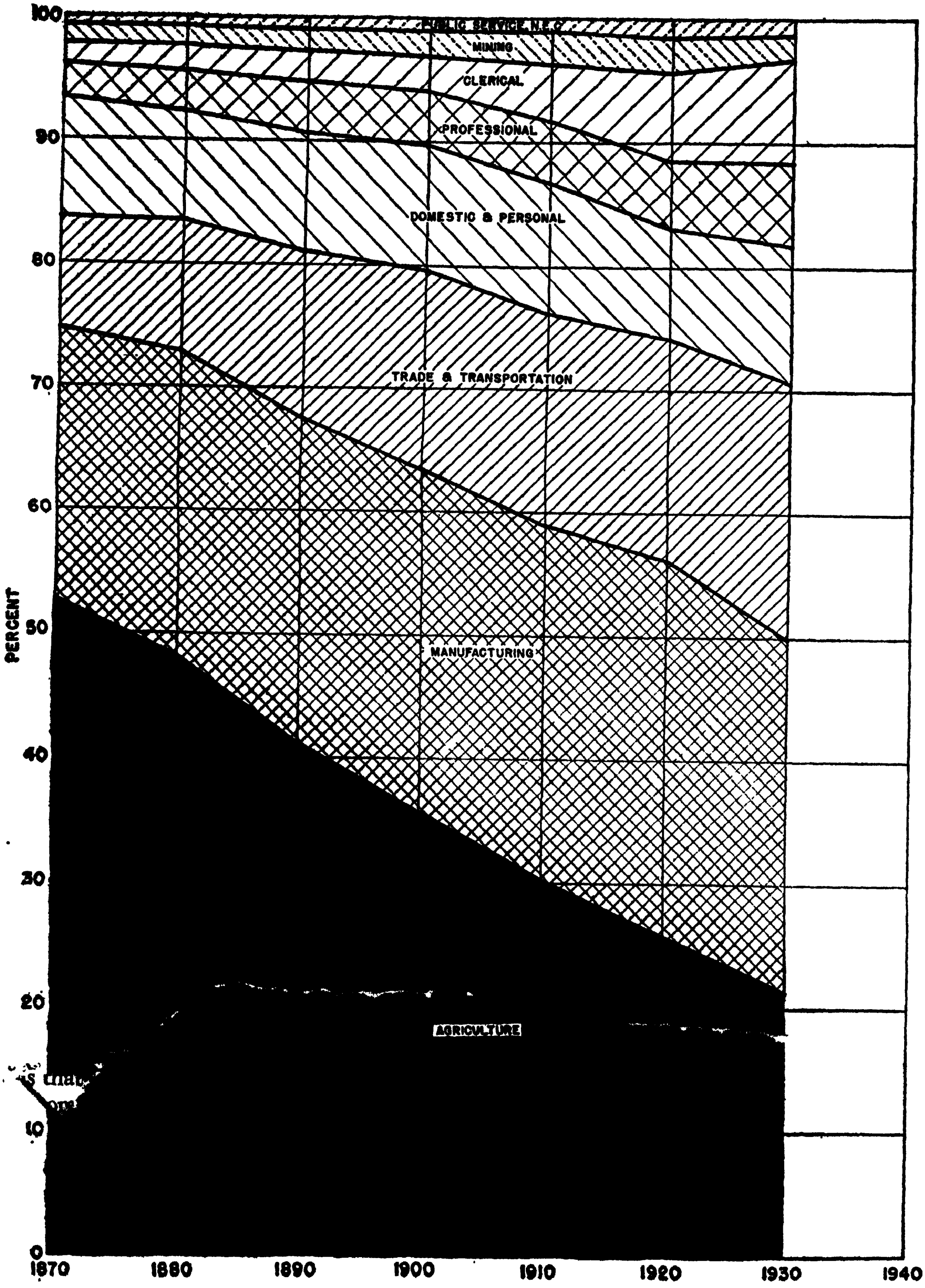

FIG. 1. Proportion of Gainfully Employed Over 16 Years of Age, by Major Occupational Groups, 1870–1930. (From National Resources Committee, *Structure of the American Economy*, p. 65. Source: Report of the President's Research Committee on Social Trends, *Recent Social Trends in the United States*, 1983, Table 6, page 281. Figures differ slightly from those in Census reports; adjustments have been made to obtain comparable figures.)

The rising percentage of labor employed in manufacturing does not show the full increase in manufactured goods, because the productivity of labor was growing rapidly and the output of goods was expanding far more rapidly than employment. One of the most important increases in employment was in the field of trade and transportation—one aspect of the growing integration of our economy and the increasing volume of goods bought and sold. In the simple economy of 1870, families and communities were largely isolated, self-sustaining, and much of the trade was local, with relatively few things bought in the market. Today the entire nation is knit together in one integrated whole, with almost everyone producing goods for sale to others who may be scattered throughout the length and breadth of the land; where the consumers of 1870 bought hundreds of products, many of them locally produced, the consumers of today buy thousands of products from every part of the country and of the world. Trade and transportation have called for a growing proportion of the country's labor force. And all this, with the increasing prevalence of big corporate business, has attracted a rapidly rising percentage of workers to clerical work.

Diminishing productivity

It is the function of the entrepreneur to combine land, labor, and capital in such a way, and in such proportions, as will net him the maximum profits; and in doing this he always faces the broad principle of "diminishing productivity" or "variable proportions," or, as it is sometimes called, "non-proportional outputs." In this book we shall call it the principle or law of diminishing productivity.

The principle of diminishing productivity may be stated as follows: *If any two of the three factors of production—land, labor, and capital—remain fixed, and units of the third are added, a point will be reached at which additional units of the third or varying factor will add less to the total product than the units previously applied.* In other words, if in any industry or any productive process the amounts of land and capital are kept stationary and laborers are added, a point will be reached where additional laborers will add less to the product than those previously hired. Indeed it is conceivable that a point might be reached at which additional laborers would be so much in each other's way that they would add nothing to the product, or might even reduce the output. The same principle would apply in the addition of units of capital to fixed amounts of land and labor, or in the addition of units of land to fixed amounts of labor and capital.

If we break up the three factors—land, labor, and capital—into the numberless productive agents which they include, the principle of diminishing productivity will apply to each one of these agents. For instance, more than a hundred productive agents are employed in the operations of any good farm—cattle, horses, fences, mowers, rakes, engines, fertilizer, and the like. If units of any one of these agents are added, a point will surely be reached where these additional units will add less to the total product than those previously added. The farm manager must not have too many cattle, or horses, or fences, or anything else. Similarly, in organizing his store, the merchant will face a diminishing productivity in his investment in every kind of goods, in floor space, in display cases and equipment, in window displays, in labor, and in every other productive factor.

Not only is there a diminishing productivity in all productive factors included in the three categories of land, labor, and capital, but there is similarly a diminishing productivity for entrepreneurs. The more capable entrepreneurs there are, the less will be the productivity of any one of them. Carver points out that scarcely anything is more needed in our economic society than a larger number of capable entrepreneurs, since they would raise the wages of labor and the interest rate on capital, while they would reduce their own productivity and so reduce the fabulous entrepreneurial rewards which democratically-minded people so often complain about.

The principle of diminishing productivity is even broader in its significance than this seems to suggest. As Marshall says: "Excessive applications of any means to the attainment of any end are indeed sure to yield diminishing returns in every branch of business; and, one may say, in all the affairs of life." In the manufacture of automobiles, for instance, there should be a balance of all the various parts, in quality, appearance, and durability. There is a diminishing return, or productivity, on expenditures for quality of metal in every part, for beauty and durability in upholstering and in finish everywhere, for power and pickup, for ease in driving and comfort in riding. The ideal automobile should be so built that all its appointments would balance in quality so that, like the deacon's one-horse shay, all its parts would wear out at once. This same principle applies to all machines, and indeed to all articles of whatever sort. The manufacturer of kitchen knives who spends too much on the quality of the steel in the blade, in relation to durability in the handle, encounters diminishing productivity in the former. The shoe manufacturer who uses leather of high quality with workmanship of relatively low grade encounters diminishing productivity in his expenditure for the leather. The merchant may devote energy to window dressing, to advertising and salesmanship, beyond the point of diminishing productivity and may thus reduce his profits. Some businessmen have hobbies, extravagances, in their businesses, in which they indulge even at a loss, as for instance, the magnificent horses that many brewers used to drive.

In our cities we see diminishing productivity in the use of automobiles. When there were only a few automobiles, the owners of those cars found them a great convenience; but as more cars appeared, congestion became greater, not only on the streets and boulevards but at parking places. So great is this congestion in very large cities that some people do not own cars but use the streetcars instead.

To take another illustration, a few labor-saving gadgets in the house may increase the housewife's efficiency considerably, but in adding gadgets a point is presently reached where their productivity begins to decline; and a point might conceivably be reached where additional gadgets would take up so much room and require so much time for their care and operation that they would actually reduce the amount of work done. Something like this would also be true of servants. One servant might be very useful in a home, to cook and sweep and dust, but as more servants are added, the returns will diminish.

"In all the affairs of life" this principle is important. The student encounters it in his education. Some education is almost indispensable. He must learn to read and write, and a high school education is surely worth while to him. Perhaps a college education may be worth the effort and expense required for it, but it is probably of less use than a high school education; this means that diminishing returns have been encountered. As years of graduate work are added, the returns will probably diminish further, until, it is conceivable, he might devote so much energy to college training as actually to reduce his productive efficiency. And just as the size of a business establishment depends in part on the ability of the entrepreneur, so the amount of education that can be profitably acquired depends on the natural abilities of the student.

What principle determines how many units of each productive factor shall be used? The entrepreneur does not stop adding units of any factor at the point of diminishing productivity but continues to apply units of each factor until he reaches the point where the last unit, the marginal unit, adds just enough to the product to pay its cost. To stop short of this point would be to fail to make maximum profits; to add more would involve a loss on the last unit, and so reduce profits. It is of course impossible for the entrepreneur to ascertain this point with exactness, yet he doubtless does it with considerable sagacity.

The amount of any given productive factor that the entrepreneur can use profitably thus depends upon two things, the price he gets for the product and the price he must pay for the factor under consideration. The higher the price of the product, other things remaining the same, the more of any given factor, or of all the factors, he will employ; and the lower the price of the product, the less of all the factors he can employ. On the other hand, the higher the cost of any factor, the less will he use. He economizes on the expensive factors and uses large amounts of the factors that are cheap.

The entrepreneur is constantly weighing the advantages and disadvantages, the revenues and costs, of employing different combinations of productive agents; and in employing each productive agent up to the point where its *marginal cost—the amount added to his total* *cost by adding the last unit*—equals the *marginal revenue—the amount added to his total revenue by adding this unit*—he tends to bring his costs into such relationship that equal marginal expenditures for each agent bring equal marginal revenues. A merchant who has his business efficiently organized will be in such a position that the last $100 expended for labor of each sort—for showcases and floor space and window dressing and advertising and delivery and stock—will bring him equal additions in revenue. This is done not all at once, but over a period of time, by the process of hit and miss, trial and error; and successful businessmen are generally sagacious in making the most profitable adjustment.

The process of apportioning expenditures among the various agents of production is to some extent a matter of *substitution,* and to some extent a matter of adding *complementary* factors. A canning company, for instance, may purchase a machine which enables it to dismiss a number of workers. Here the machine is a *substitute* for labor. On the other hand, if the canner builds an addition to his factory and installs more of the ordinary canning equipment, he is likely to need *more* labor. Similarly, if a merchant rents more room, he may have to add more equipment and more stock, and may perhaps have to advertise more heavily, adding as before until the marginal cost of each agent equals the marginal revenue gained by its addition.

It might seem that if the entrepreneur keeps his factors or agents of production in the right proportion, he might continue expanding indefinitely; but no matter in what proportions he uses them he reaches a point beyond which further expansion is unprofitable. What is it that sets the limit? Technological factors—the kinds of machines and equipment used—and a considerable number of other factors establish a limit to the size of plant appropriate to each industry, although this limit has considerable elasticity. Steel mills and automobile plants must generally be large; farms, retail stores, garages, and custom tailoring shops must generally be small. The automobile manufacturer cannot operate a small plant at a profit, and the farmer can seldom expand his enterprise to a great size.

The relative sizes *of the various enterprises in a given industry* are likely to have a fairly definite relation to the ability and energy of the entrepreneurs. An able and energetic farmer will have more land and perhaps better land than a less able man, more capital of all kinds—cattle, horses, tractors, implements—and better grades of everything. This is a fortunate circumstance, one of the economies of capitalism. It would be a most wasteful system if the talents of able farmers had to be used on small farms, poor land, and poor equipment; just as it would be wasteful to have men of little ability farming large farms with good land or using much good equipment.

The classical law of diminishing returns

When we look at this principle as it relates to the entire economy, however, we find that it works, in reality, only one way. For the economy as a whole, only one factor is fixed—land. Labor and capital may increase, but not land; indeed the history of the United States since the public lands were all taken up about fifty years ago is a story of increasing labor and capital on a fixed amount of land. Here are the conditions essential to the *classical law of diminishing returns.*

The law of diminishing returns is *one aspect* of the great general law of diminishing productivity. It will be remembered that the latter assumed *any* two factors stationary and the third increased. In the law of diminishing returns we have the one factor of *land* fixed, and a composite unit of *labor* and *capital* increased, with diminishing productivity for the latter. The law has been stated by Marshall as follows: "*An increase in the capital and labour applied in the cultivation of land causes* IN GENERAL *a less than proportionate increase in the amount of produce raised, unless it happens to coincide with an improvement in the arts of agriculture.*"

Under what circumstances will capital and labor be added beyond the point of diminishing returns? The answer is simple—whenever land ceases to be free. If land is free, it may be assumed that farmers will not cultivate their land beyond this point, but will instead take more land. According to Marshall, "Wherever the right to cultivate land is much in request, we may be sure that the tendency to a diminishing return is in full operation. Were it not for this tendency every farmer could save nearly the whole of his rent by giving up all but a small piece of his land, and bestowing all his capital and labour on that. If all the capital and labour which he would in that case apply to it, gave as good a return in proportion as that which he now applies to it, he would get from that plot as large a produce as he now gets from his whole farm; and he would make a net gain of all his rent save that of the little plot that he retained."[2]

The law of diminishing returns is often discussed as a principle of great importance in the practical business of farming, but the individual farmer does not need to worry much about it. The law is a broad social principle, of very great and very unhappy significance to some nations and peoples, each of which has, in accordance with the law, only a certain *fixed amount of land,* perhaps not enough to provide adequately for the people, even with the most intensive cultivation. The individual farmer is in no such situation. He is not limited to a fixed amount of land. Unlike a nation, he can buy more land if he has the money, just as he can borrow more capital or hire more labor; indeed many of the more prosperous farmers, those with large farms, get at least a part of their land by buying. To the individual farmer, land is no more fixed than are his other factors of production.

The law that the individual farmer is concerned with is not the broad social law of diminishing returns but the law of diminishing productivity. His problem as a farm operator is that of combining land, labor, and capital in such proportions as to secure the maximum net income for himself; and this is accomplished, theoretically, by adding units of each factor until the marginal revenue resulting from the addition of the last unit just equals the marginal cost of that unit. The character of farm operations of course varies according to the cost of the factors and the prices of the products. Where the prices of farm products are high, and land is expensive, and labor and capital are cheap, as in such densely populated countries as Belgium and Holland, the individual farmer finds it profitable to apply much of the cheap labor and capital to little of the expensive land—to cultivate *intensively.* Where, on the other hand, farm products and land are cheap, and labor is dear, as in the United States and Canada, it pays to apply little labor to much cheap land—to cultivate *extensively;* yet even in the United States the individual farmer presumably applies capital and labor beyond the point of diminishing returns, because he does that whenever land is no longer free. Only when land is free will he cultivate to, and not beyond, the point of diminishing returns.

The law of diminishing returns in urban land use

Here we see the reason why the law of diminishing returns is of no significance in the utilization of urban land. In the use of agricultural lands, farmers cultivate beyond the point of diminishing returns only when there is no longer any free land. In the utilization of urban land there is no reason for "cultivating" beyond this point because there is a hundred times as much land available for urban use as anyone wants. It can be had on the outskirts of every city *practically free,* that is, for only the small payment necessary to get it away from agricultural uses. With plenty of practically free land, users of urban land have no incentive for using capital and labor beyond the point of diminishing returns. The labor and capital devoted to building and operating the seventieth story of a building in Radio City produce just as large a return as the labor and capital employed for the second story of the buildings on the fringe of urban use, or along the main street of Eudora, Kansas. They would have to yield as large a return, or the Radio City building would not have been built so high.

The law of diminishing returns is a cruel principle in its application to agricultural production in a densely populated country. It means that people must be poor, and often hungry. It can mean no such thing in the city, for the returns from the investment of capital and labor are just as high there as in the small town. If they tended to be less, the big city would soon shrink in size until the marginal investment of capital and labor brought as high a return as in the smaller cities.

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[2] From Alfred Marshall, *Principles of Economics,* p. 151. By permission of The Macmillan Company, publishers.

Some land in a big city is "scarce," to be sure, but merely because people swarm there to do business with each other; many want to be there because so many others are there, but there can be no general loss or hardship from this. The costs of doing business on these "scarce" and valuable sites are no higher than they are out on the fringes of the city, or in smaller cities and towns; for of course if they were higher, business would move out to the fringes and to smaller cities where there is plenty of land to be had practically free, that is, at a cost a little above that of farm land.

The law of diminishing returns in mining

Mining and the extractive industries are subject to diminishing returns only in a certain sense. As coal shafts, oil and gas wells, and metal mining tunnels are driven deeper, as exploitation is carried into more inaccessible regions, as poorer deposits are drawn upon, the returns per unit of capital and labor necessarily decline. Coal mining in some parts of Europe, oil and gas production in the eastern part of the United States, and lumber production in the United States as a whole have yielded diminishing returns for a number of years. In general, however, it is misleading to speak of diminishing returns in mining and the extractive industries. The product of mines is not, like that of agriculture, a constantly recurring product, a "perennial stream," as Marshall puts it. It is a part of the *mine itself*. Corn and wheat may be produced for an indefinite time if the land is properly cared for, whereas every mine or mineral deposit is eventually exhausted.

It is true that agriculture, as it has generally been carried on in America, is somewhat like mining in this respect. Millions of acres of sloping land have been so eroded as to be worthless, and considerable areas in the semi-arid plains have been ruined by the wind. To restore some of this land to its original state of fertility would require an expense greater than all the rents that it has yielded, which is to say that the land was "mined" rather than "cultivated"; but diminishing returns caused by exhaustion of the soil have little in common with the classic law of diminishing returns. In the one case the returns diminish because the soil is exhausted; in the other case, the soil is kept in its original condition, and the returns merely diminish *with additional applications of labor and capital.* In the first case, the productivity of the land, as well as that of the capital and labor, decreases; under the law of diminishing returns, the product of the *land* per acre increases.

Land supply fixed in some respects

For society as a whole, the amount of agricultural land of any given grade is fixed, and therefore the conditions of the law of diminishing returns are applicable. It is true that land may be made productive which was not productive before—the sea may be diked out, as in Holland; arid land may be irrigated, swamp land drained, forest land cleared, sloping land terraced, infertile land fertilized—but, strictly speaking, such land is in the nature of capital, in part, at least, created by man. Land has already been defined as the gifts of nature, and so by definition it is fixed in amount.

Law of diminishing returns not as sinister as once believed

For several reasons the law of diminishing returns, in most progressive countries, has not had the sinister results that many economists of past generations feared. In the first place, although in practically all countries the supply of labor increased, the supply of capital increased much more rapidly and enabled the average laborer, although he had less land, to produce more. In the second place, the "arts of agriculture" have generally improved, as they inevitably would in any society of energetic people. When such a people found themselves suffering from a scarcity of farm products, they sought ways of mitigating the evils of their situation. Even in the United States, although farm products were generally plentiful and cheap, there has been great progress in agriculture. Agronomists have been employed to seek out hardier and more productive varieties of crops, to improve the strains of those already grown, and to learn better methods of cultivation; experts in animal breeding have developed better strains of livestock and better ways of feeding and caring for animals; soil experts and chemists have worked indefatigably on the problem of increasing the fertility of the soil; irrigation and drainage have been employed to correct deficiency or excess of moisture. The introduction of hybrid corn is said to have added more than 600,000,000 bushels to our annual corn yield. The production of butterfat, per cow, has very nearly doubled since 1890.

It should be noted, too, that an increase in population, which forces cultivation beyond the point of diminishing returns, tends to bring compensating advantages in a better organization of trade and industry; and therefore, as Marshall points out, "the law of diminishing returns does not apply to the total capital spent in a district as sharply as to that on a single farm." In fact, even after diminishing returns have set in on individual farms, it is possible that a further increase in population may bring more than a proportional increase in the means of subsistence. Marshall says further:

> In fact every farmer is aided by the presence of neighbours, whether agriculturists or townspeople. Even if most of them are engaged like himself in agriculture, they gradually supply him with good roads, and other means of communication: they give him a market in which he can buy at reasonable terms what he wants, necessaries, comforts and luxuries for himself and his family, and all the various requisites for his farm work: they surround him with knowledge: medical aid, instruction and amusement are brought to his door; his mind becomes wider, and his efficiency is in many ways increased. And if the neighbouring market town expands into a large industrial centre, his gain is much greater. All his produce is worth more; some things which he used to throw away fetch a good price. He finds new openings in dairy farming and market gardening, and with a larger range of produce he makes use of rotations that keep his land always active without denuding it of any one of the elements that are necessary for its fertility.[3]

Exactly what the balance of the forces tending toward diminishing returns and toward increasing returns is, in the United States, is a difficult question. There is no doubt that in certain sections of the South the forces tending toward diminishing returns are dominant; but in most parts of the country it is not certain that the forces tending toward diminishing returns are dominant, or, to put it in another way, it is not certain that the people would live better if the population were smaller.

QUESTIONS

1. Why is it important to prevent, as far as possible, the acquisition of wealth by unproductive activities?
2. Define production. Which of the following are producers: poets, violin makers, violinists, bartenders, domestic servants, barbers, oil stock salesmen, brokers, makers of patent medicines?
3. Does income measure the value of a man's service to society in the following cases:
   a. A lawyer making $500 by clearing a burglar.
   b. A usurer who makes 100 per cent interest on money lent to improvident Negroes.
   c. A teacher who spends his time advertising himself instead of learning his science.
   d. A politician telling of his love for the people.
   e. A banker lending out other people's money at 8 per cent.
   f. A doctor treating a patient who imagines all his ills.
4. Doubling the efficiency of every salesman in Kansas would have what effect on the wealth of the state? Would it have more or less influence than doubling the efficiency of an equal number of farmers? Should the university teach salesmanship and advertising? Why or why not?
5. Are the laborers of the United States naturally more vigorous and efficient than those of Europe? Why are most people of tropical countries lazy?
6. Why has the proportion of the labor engaged in agriculture declined over the past cen-

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[3] From Alfred Marshall, *Principles of Economics*, p. 165. By permission of The Macmillan Company, publishers.

tury? The proportion engaged in professional work, in trade and transportation, and in clerical work has increased. Why, in each case?

7. How would an increase in the supply of labor affect the average productivity of labor, other factors remaining the same? How would it affect the productivity of capital? Of land?
8. Is it possible that the addition of a second mule on a sharecropper's farm might more than double his output? In adding mules to his equipment, is it conceivable that the sharecropper might get so many that the last mule would add *nothing* to the output? Is it conceivable that a merchant might add to his sales force until the last man would add nothing to his output?
9. How does a merchant apportion his expenditures for salesmen and saleswomen, stock, floor space, showcases, window display, and advertising? What, in the long run, determines the size of his establishment?
10. State the law of diminishing returns. How could the law be valid when the United States, with a steadily increasing population, enjoys a generally rising plane of living?
11. According to the law of diminishing returns, which of the following products should increase most in price during the next century: baby beef, bologna, pork, butter, buttermilk, cream, cheese, wheat, cabbage, apples, corn, bicycles, typewriters, hand-carved chairs, beans, potatoes? Arrange in order of their probable rise in price.
12. Why is not the law of diminishing returns of any significance in the urban use of land? Why are there no very high buildings in small towns? Why did some of the shoe factories near Brockton, Massachusetts, build three-story buildings when land could be had at a merely nominal price?
13. The individual farmer does not worry much about the law of diminishing returns. Why?
14. "The produce of mines again is said to conform to the law of diminishing returns; but this statement is misleading." How is it misleading?
15. In the dairy herds owned by 452 dairy-herd improvement associations, the production of butterfat per cow increased as follows:

    1920—247 pounds
    1928—284 pounds
    1930—302 pounds
    1932—310 pounds

    Is this a contradiction of the law of diminishing returns?
16. If there were no law of diminishing returns, would the people of China live as well as we do? Where, in the United States, would you find people suffering from this law?
17. In many industries, after a given company grows beyond a certain size, its cost of production increases because of the unwieldiness and red tape that go with large concerns. Is this an illustration of the law of diminishing returns? Explain. Is the tendency of the fertility of land to decline with years of cultivation to be regarded as an illustration of this law? Explain.
18. "Excessive applications of any means to the attainment of any end are sure to yield diminishing returns in every branch of business; and, one may say, in all the affairs of life." Give illustrations of this.

Chapter 3.

Land

Definition of land

Land has been defined by Marshall as "the material and the forces which Nature gives freely for man's aid, in land and water, in air and light and heat." This definition would serve reasonably well, but we have already seen that the gifts of nature include more than is mentioned here: not only the soil and water, but urban sites; all the minerals beneath the surface of the soil; everything above the surface of the soil, including not only "air and light and heat" but the rain and snow and all that goes to make up climate; the fish of the sea and the native wild game on the land, virgin timber and wild fruits; and finally, the forces of nature, such as wind, waterfalls, and tides. Electricity, except in the unusuable form of lightning, is not a source of energy but merely a new form into which existing energies can be changed.

Classification of land

Land may be classified in different ways, but perhaps the following classification will serve as well as any:

I. Agricultural land:
    Ordinary agricultural land
    Land deficient in rainfall:
        Range land
        Irrigable land
        Desert land, non-irrigable
    Wet or swamp land
    Forest land
II. Urban land:
    Industrial sites
    Wholesaling sites
    Retailing sites
    Apartment sites
    Residential sites
    Suburban sites
III. Mineral land:
    Metalliferous:
        Iron
        Copper, etc.
    Non-metalliferous:
        Hydrocarbons:
            Coal
            Oil
            Natural gas
        Fertilizing minerals:
            Potash
            Phosphate
        Building materials:
            Stone
            Marble, etc.
IV. Recreational land:
    Parks, national, state, and city
    Wilderness areas
    Beaches and lakes
    Wild life
V. Water resources:
    Water power
    Transportation, navigable lakes and rivers
    Irrigation waters
    Urban water supplies

Value of different kinds of land

Valuation of land is a difficult problem, but one American statistician has made the following estimates for the United States for the year 1938:

Natural Resources, Value, 1938[1]

Land used for production:		
Farm land	26	billion dollars
Industrial and commercial land	20	" "
Railroad land	2	" "
Utilities land	3	" "
Total	51	" "
Land used for comfort:		
Non-farm residential land	48	billion dollars
Tax-exempt land	18	" "
Total	66	" "
Total land (natural resources)	117	billion dollars

Land as the "gifts of nature"

In defining land as the gifts of nature, we do not assume that such gifts are generally available without the efforts of man. It is true that air, sunlight, and moonlight need not be "found" or "mined" or converted into something else. They may be enjoyed by all as nature provides them; yet in the cities better air and sunlight and moonlight are available for those who can afford to move to the suburbs. Urban lands cannot be utilized without a heavy expenditure for streets, sewers, water mains, lighting, and traction systems; in fact, it is sometimes claimed that the total cost of such man-made utilities is greater than the value of the land. Coal in the bowels of the earth is useless; oil and gas and minerals must be found and brought to the surface; fish must be caught, game must be hunted, wild fruits must be gathered, wind must be harnessed by windmills, expensive dams and machinery are required for the utilization of water power, a salubrious climate is useless unless there are houses for those who would enjoy it, and the richest agricultural land in the world must lie idle until man makes it accessible.

The "productivity" of land

Land may be productive of different kinds of utilities. Agricultural land provides us with plant food and other valuable commodities—grass, wheat, corn, apples, cotton, timber, and the like. Urban land is productive of utilities of a different sort—sites for homes, for industrial operations, and for business transactions. The ocean and some large lakes and rivers provide a means of cheap transportation; oil deposits provide us with heat and power; falling water may be converted into power, and perhaps into heat; iron and copper and the other mineral deposits afford the metals from which to make machines; mineral springs provide water of healing properties, and the climate of certain locations is valuable in the treatment of disease.[2]

Land is sometimes referred to as a peculiarly *durable* agent of production. Ricardo wrote of the "original and indestructible powers of the soil," but such a phrase is misleading, for even the richest agricultural land is to some extent liable to exhaustion. The various kinds of land vary widely in durability.

The fundamental attribute of land

Marshall has pointed out that "the fundamental attribute of land is its *extension.* The right to use a piece of land gives command over a certain space—a certain part of the earth's surface"; and in its "extension" land is indestructible. A farm may lose much of its original fertility and its valuable chemical elements, it may be eroded by rains, may grow up in destructive weeds; but its area, its "extension," will remain the same. Subject to slight climatic changes arising from drainage, from the creation of lakes, or from the destruction or planting of forests in the vicinity, this plot of land will receive "an annual income of heat and light, of air and moisture" over which man has but little control. "Extension" and climate are largely indestructible qualities of land.

It is in urban land that the quality of extension is most important. Urban land is indestructible in the sense that its location, which gives it value, is unchangeable. Man's action may change the value of one district of a city as compared with another, for instance in building a depot or a schoolhouse in a certain part, or in permitting undesirable industries to be built nearby; and man's action may even create or destroy most of the land values in a city. Many towns and cities owe their origin partly to the building of railroads, and in the past few years many towns have been abandoned because railroads were torn up. Generally, however, the growth of large cities, and of land values in cities, is due largely or partly to natural conditions, and is to that extent unchangeable. New York, with her fine harbor, on the Hudson River–Mohawk valley route to the Great Lakes and the interior of the country; Chicago, at the southern end of Lake Michigan; Duluth, at the west end of Lake Superior; Toledo, at the west end of Lake Erie, and Buffalo, at the east end; New Orleans, near the mouth of the Mississippi; Portland, near the mouth of the Columbia; Philadelphia, near the head of navigation on the Delaware; St. Louis, at the junction of the Mississippi and Missouri Rivers; Kansas City, at the junction of the Missouri and Kansas Rivers; Omaha, near the junction of the Missouri and Platte Rivers—all these were destined by nature to be important cities, although man-made railroads have added greatly to their importance.

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[1] Robert R. Doane, *The Anatomy of American Wealth,* p. 147. The corresponding figures for the present are much higher.

[2] For a careful discussion of this, see E. U. Zimmermann, *World Resources and Industries,* especially chap. 6.

Differences in the destructibility of various resources

Natural resources differ greatly in their destructibility. Water power, once developed, may last a long time, but the impounding reservoirs created by dams will eventually fill with silt and lose much of their value in equalizing stream flow. Timber lands, properly cared for, may be regarded as entirely indestructible and will produce a forest crop for an indefinite time, but of course the virgin timber may be cut in a very short time. Wild game and fish, properly protected, may be maintained indefinitely, but some species may be largely destroyed or even completely exterminated in a short time. Some sixty-six species of birds that once lived in the United States are now extinct. Mineral resources not only *may* be destroyed, but *must* be destroyed in the process of rendering their utilities; yet a distinction must be drawn between those which are inevitably destroyed in use and those which in one form or another may be preserved a long time. Coal, oil, and natural gas are destroyed in burning; phosphate or potash applied to the soil lasts only a few years at most; ores are destroyed in conversion into metal, but the metals may last a long time as finished products, if properly protected. Such metals should, however, be regarded as capital or consumers' goods.

The distinction between land and capital

One of the controversial questions in economics relates to the distinction between capital and land. Not a few able economists insist that no valid distinction can be drawn; that to the individual farmer or businessman the investment in land is quite like investment in capital; that land is not "indestructible," as Ricardo seemed to suggest, but that many kinds of land may be wasted or ruined, just like capital; that while it is impossible to create land, it is possible to irrigate dry land, drain swamp land, fertilize poor land, and by the development of better transportation even to *increase* the amount of *usable* land. Scarcely any agricultural land has its "original and indestructible powers"; almost all of it has a mixture of original qualities and man's contribution, a mixture that could not possibly be resolved and identified.[3]

With much of this we must agree. There is no precise and absolute distinction between land and capital. With respect to every significant quality of land, land shades gradually into capital. With respect to its natural origin, it can only be said that land as a productive agent generally owes *more* to nature than does capital. A farm of rich, level Iowa land owes much to nature and little to man's efforts; a poor, sloping farm, if by terracing and fertilization it is made productive, owes less to nature and more to man. An irrigated farm in California owes much to nature, to the fact that nature has provided a warm and equable climate and mountain snows from which water may be secured; yet man has done much here in bringing the water down from the mountains. Without his contribution, as without nature's, the land would be nearly worthless. Irrigated land may be regarded as partly land in the economic sense and partly capital. An urban site in New York City owes much to nature—to the fact that New York has the best harbor on the east coast and is connected with the Great Lakes region by the Hudson River and the Mohawk valley; but much of the productivity and value of land in New York City is due to the building of railroads and the Erie Canal. Land in such cities as Wichita, Kansas, and Des Moines, Iowa, owes less to nature and more to man-made railroad connections.

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[3] See *American Economic Review*, March, 1930, pp. 78, 79.

All capital, on the other hand, owes something to nature. Steel rails are made from iron ore produced by nature, smelted and refined by man; the blade of a knife comes from the same source, with a greater relative contribution by man. A wooden bridge in Oregon owes much to nature and something to man. A hand-carved desk owes less to nature and much more to man. To the extent of nature's contribution, capital might be considered land; and to the extent of man's contribution, land may properly be considered capital. It is a question of more or less, and not an absolute distinction.

Land is said to be fixed in amount, whereas capital is indefinitely expansible. Nature has provided only a certain amount of natural resources and is not adding to that amount; but by working and saving we can increase the amount of capital to almost any extent. From our definition of land as the gifts of nature this distinction would appear to be valid; yet it is not so precise as we might wish. We can make land usable and productive which was not so before, and whether we then call it land or capital may not seem to be an important matter. The amount of *usable* land is not determined altogether by nature, because there are many grades of land, and changing economic conditions often increase or reduce the amount of land used. A rise in the price of farm products, for instance, will tend to bring more land into use, land which formerly was not worth cultivating. Other resources are similarly of different grades—forests, water power, and mineral deposits—and changes in the prices of such resources will bring changes in the amounts that can be profitably utilized. The supply of urban land is limited only by transportation facilities.

Land is generally more durable than capital, but here again the distinction must be loosely drawn. In its "extension" land is indeed indestructible. A quarter section will always be the same area and will receive the same "annual income of heat and light, of air and moisture"; but the fertility of even the richest level land may be reduced by continuous cropping if no fertilizer is applied, and sloping land may be worn out in a few decades, or even less. Such land may be less durable than the buildings on it. In some parts of the United States fairly good houses are still standing on farms that have been ruined by erosion. Land is generally more durable than capital, but this is not always true.

It must be conceded, finally, that to the individual farmer or businessman land does not differ from capital in any important respect. To him the land is not a gift of nature, for he must pay for it just as he pays for his capital; to him it is by no means fixed in amount, since he can buy all that he wants and can pay for; his land may be more durable than his capital, but the distinction is not of fundamental significance to him.

Granting all this, we must nevertheless concede that the distinctions between land and capital are significant. While the supply of *usable* land is not absolutely fixed, it is much more nearly fixed than the supply of capital, and the supply of land of any particular grade is absolutely fixed. From the broad social point of view this may be a very important matter. More than half the human race live in poverty because their land area is insufficient to provide a good living. It is true that the people of the United States have suffered little in the past from land scarcity, yet our mineral and forest reserves are growing smaller every day, and we shall probably suffer some day from scarcity of timber, natural gas, oil, many minerals, and finally even coal. Since the supply of land of any particular grade and in any particular location is absolutely fixed and since it cannot be moved, its price may rise almost infinitely, as in New York City, whereas the price of capital, as indicated by the rate of interest, seldom varies much from its normal level of 2 to 4 per cent. A further consequence of the inelasticity in the supply of land is the fact that taxes on land do not reduce the supply of it, and therefore do not raise the prices of the products of the land, whereas taxes on capital always tend to reduce the supply of capital. Finally, the land provided by nature must always be the home of the human race and is a powerful factor in determining the quality of every civilization, and therefore any permanent waste or destruction or deterioration of the land may have grave results on all future generations; waste of capital, on the other hand, can usually be made good. A wise and enlightened government will guard its land resources with particular care.

Land "shades" into other factors of production

Just as land, in its definition as the gifts of nature, shades gradually into capital, according to the principle of relativity, so does it also shade into labor and into the entrepreneurial factor. Some of the qualities of labor—strength, alertness, natural intelligence—are in a sense gifts of nature, although less enduring than the fertility of good Iowa land; and the business sagacity of successful entrepreneurs is also largely a natural gift. Since land is the gifts of nature, some economists consider rent an unearned income; and to the extent that high wages and profits are due to natural gifts they are also in a sense unearned.

Significance of land

It is difficult to exaggerate the long-run significance of the land factor in economics. Unless countries that have rich land resources are overpopulated, they are able to maintain a high standard of living, with all that it implies, whereas the people in countries with poor land resources seldom enjoy comfort, often living in a state approaching savagery. Most of the great civilizations of antiquity grew up where the climate was mild, where agricultural land was highly productive, and where natural barriers protected the people from invasion, or, in somewhat later antiquity, where the natural environment was favorable to commerce. Only in favorable environments was it generally possible for primitive savages to accumulate a surplus that would enable them to start their long climb up to wealth and civilization. As Buckle puts it: "In the first formation of society, the wealth must accumulate before knowledge can begin. As long as every man is engaged in collecting the materials necessary for his own subsistence, there will be neither leisure nor taste for higher pursuits; no science can possibly be created, and the utmost that can be effected will be an attempt to economize labor by the contrivance of such rude and imperfect instruments as even the most barbarous people are able to invent."[4]

Egypt, with her fertile Nile valley inundated each year by river floods to renew its fertility, was the home of the first important civilization. The Chaldeans, Babylonians, and Assyrians in the Tigris-Euphrates valley were obliged to use irrigation, but under irrigation the land was very fertile. In the fertile valleys of India and China civilization likewise appeared early, although for some reason, as in Egypt and Mesopotamia, it did not flourish greatly during the later centuries. Phoenicia, on the eastern shores of the Mediterranean Sea, was admirably situated for commerce with Egypt and the other developing centers of civilization, just as Greece was at a later date. Much of the land in Rome was originally fertile, although its fertility declined greatly during the later Republic. The Italian cities were able to lead Europe out of the Dark Ages because of the profits of commerce, for which their location gave them many advantages, and because of the stimulating influence of their commercial activities.

It is interesting to speculate on the reasons why such ancient civilizations as those of Egypt, Babylon, India, and China, with the long start that they had, did not continue their development. No conclusive answer can be given, but probably the climate, at least of Egypt, Babylon, and India, was less invigorating than that of countries farther north. Buckle suggests that while the first appearance of civilization depended mainly upon the fertility of the soil, its continued progress depended upon the energy of the people, which was greatly influenced by the climate. At any rate, as certain peoples developed the wealth necessary to withstand the rigors of a colder climate, centers of civilization moved northward, particularly to those countries that had an invigorating climate, fertile land, and the minerals, such as coal and iron, essential to industrial development—France, and later England, Germany, the Scandinavian countries, and America. England had not only a variety of minerals but a long coast line with excellent harbors which served well in her expanding commerce.

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[4] Henry Thomas Buckle, *History of Civilization in England*, vol. i, p. 31.

On the other hand, certain other peoples, as for instance those of Africa, India, and China —in fact, most of the peoples of Africa and Asia—have made relatively little economic progress. There may be various reasons for this, but without a doubt an important one in most cases is the lack of a favorable natural environment—a lack of generous gifts of nature. The climate of most parts of Africa is too hot for healthful living, and many parts of that dark continent are either too dry or too wet for productive agriculture; furthermore, natural enemies of the human race, animal and insect, thrive in such numbers as to make life precarious. In parts of India and the interior of Asia conditions are similarly unhealthful and rainfall is too heavy or too scant for productive agriculture. Much of South America too, in the Amazon and Orinoco valleys, is tropical and far too wet for ordinary agriculture, and other parts are too mountainous or too dry. In the regions of good climate and fertile soil, and in those where minerals abound, wealth is growing and important centers of culture are developing.

It has often been assumed that civilization develops best in temperate rather than in warmer climates because a temperate climate offers more *obstacles* to man's efforts, more *hardships* to strengthen his character. The truth is, however, that temperate climates, with their alternating cold and warm seasons, are really most favorable to man's efforts. As Carver says: "He has here fewer unconquerable enemies than in the tropics or in the frigid zones. He finds a wider variety of useful materials, such as grass, timber and minerals, and he finds them in greater abundance here than elsewhere. Here the advantages to be gained by work are more obvious and more easily comprehended than anywhere else."[5] In the temperate zone there are fewer venomous insects and reptiles, fewer disease germs deadly to man and his livestock, fewer insects to eat his products when matured. Frost in such climates kills many injurious insects and loosens the soil, snow provides soil moisture for the coming season's crops, and summer days are longer farther north.

A favorable natural environment, fertile soil, and rich natural resources not only make *possible* the accumulation of wealth, but stimulate energy and enterprise by offering large rewards for productive activity, and so are an important factor in the determination of human character. Iowa farmers are energetic, ambitious, and progressive, not only because the climate of Iowa is healthful and invigorating, but because these farmers know that their efforts will be generously rewarded. The hillbillies of the Ozark Mountains are lazy and unprogressive and lacking in ambition, not entirely because of their warmer climate, and not at all because of racial inferiority—for they are of as good racial stock as America can boast—but because they know that their efforts will bring small reward. They are wise enough not to waste their energies unreasonably. Doubtless one explanation of the general energy and enterprise of the American people is the fact that our rich natural resources usually offer handsome rewards for productive effort.

Whatever may be said of the influence of climate on culture, it is generally admitted that one of the most important elements in cultural progress is the contact of many cultures, and that isolation breeds stagnation. Hence any environment which provides easy access to other regions promotes cultural advancement. This explains, to some extent at least, the rise of such civilizations as those of Phoenicia, Greece, Carthage, the Italian cities, the coast towns of the medieval Lowlands and Germany, and later those of England and perhaps Japan. It doubtless explains the stagnation of such regions as the interior of Russia, China, and India. Such islands as England and Japan, however, reap more than commercial and cultural advantages from their insular situation. They are to some extent protected by water from invaders and from all the destruction and misery inflicted by foreign armies, just as Switzerland is protected by her surrounding mountains. What would be the present condition of parts of Germany, Belgium, France, and the Balkan states if they had not for centuries served as battlegrounds for the armies of Europe? German civilization suffered a terrible setback from the ravages of the Thirty Years' War. The United States may well be thankful that she has oceans on the east and west and nations with small populations north and south; but of course the bombing plane has gravely reduced the protective value of these ocean barriers, just as it exposed England to a threat that for centuries she has not known.

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[5] T. N. Carver, *Principles of National Economy*, p. 141.

Geographic determinism

A number of writers have advanced the theory that geographic factors are fundamentally important in all great historical movements—the theory of *geographic determinism.* There is much evidence to support this theory, but lack of space forbids extended discussion of it here. Some very early writers insisted that natural environment is an important element in the determination of the culture of peoples. In his treatise, "On Airs, Waters, and Places," Hippocrates made perhaps the first important attempt to trace the influence of physical environment on character. He attributed the variety, vigor, and fierceness of European peoples to their rapidly changing seasons which excited the mind, ruffled the temper, and demanded fortitude and exertion; and the "equable and gentle dispositions" of Asiatics he attributed to their mild and uniform climate.[6] Aristotle held similar views: "Those who live in a cold climate and in [northern] Europe are full of spirit, but wanting in intelligence and skill; and therefore they keep their freedom, but have no political organization, and are incapable of ruling over others. Whereas the natives of Asia are intelligent and inventive, but they are wanting in spirit, and therefore they are always in a state of subjection and slavery. But the Hellenic race, which is situated between them, is likewise intermediate in character, being high-spirited and also intelligent." Much later Peschel, in his *Races of Man,* suggested that religions are the results of geographic influences, monotheistic religions arising on desert plains, and polytheistic religions prevailing in rough forested countries such as Greece.

Without following such theories too far, we are at least safe in assuming that natural environments are fundamental factors in determining human energy and the accumulation of wealth, and therefore, to some extent, human civilization. Uncle Henry Wallace used to say that "rich land makes rich people, poor land makes poor people, and rough land makes rough people"—a rather sweeping generalization, yet partly valid. In those sections of our country where the climate is enervating and the land poor, there is much poverty, ill health, illiteracy, and low standards of public administration.

To the extent that the people of the United States can be said to have peculiar characteristics, those characteristics are no doubt in part the result of our abundance of land resources and our consequent high average income, and of the fact that until a few years ago we always had a frontier moving steadily westward. A generally sparse and scattered population, with plenty of room to move around on, our people have been and to some extent still are individualistic, impatient of rules, laws, and conventions, often lawless, with one of the highest crime rates in the world. With land available at little or no cost, the poorer classes did not develop the subservient attitude of corresponding classes in Europe; hence our society has been relatively democratic. The frontier, as Turner pointed out, dominated our national ideals and even our politics. On the frontier the people learned to be indifferent to government problems, with the result that private graft and political corruption have commonly characterized the American scene. For two centuries and a half Americans followed the westward-moving frontier, seeking a profit in the appropriation of new lands; and in this quest they developed the restless, venturesome, speculative character that to some extent is still ours. As land speculators the people always wanted land prices to rise; hence the heavy emphasis on "growth" in numbers, the blatant "boosting" which is the first duty of loyal American citizens and is carried on through organizations in every town, city, and state.

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[6] See Franklin Thomas, *The Environmental Basis of Society,* for a thorough examination of these theories; and various works of Ellsworth Huntington, who stresses geographic factors in human development.

The richness of our land endowment

The land area now known as the United States was originally one of the richest areas in the world; and this it is still, although it has suffered serious waste and depletion. Situated in the temperate zone, it has in various sections almost every conceivable climate, from semi-tropical in Florida to arctic in Alaska; and it offers a wide variety of rain conditions, from almost absolute aridity in parts of California and Nevada to rainfalls of 125 inches or more annually, along the Pacific coast. While much of the West is too dry to farm without irrigation, the climate is peculiarly healthful and invigorating, the scenery impressive, the soil highly productive under irrigation; and there are some magnificent forests, abundant water power, wide areas of grazing lands, and a great variey of useul minerals. East of the Alleghenies much of the soil is not fertile; but a number of excellent harbors, rivers navigable for considerable distances into the interior, and easy access to Appalachian coal deposits give the northern part of this section excellent advantages for manufacturing and commerce. The five Great Lakes in the northern interior provide cheap transportation for coal and iron and farm products, which are abundant in neighboring regions, and thus make possible the vast manufacturing and commercial activities of the Lake region. In the South, although the climate is somewhat enervating and malaria and hookworm are common, conditions for the production of cotton are unexcelled anywhere in the world, and this region has long produced more than half of the world's cotton, as well as large amounts of citrus fruits and truck crops.

The Mississippi valley, particularly the corn belt in the northern part within a radius of about five hundred miles of Chicago, is one of the most productive regions in the world. Here is soil deep and rich, climate ideally suited to general agriculture, with cold winters and summers of "corn weather"—summers with long, warm days and warm nights to speed the growth of corn. Corn is our most important agricultural crop, because it is not only an important cereal for human consumption but feed for poultry and livestock; and we produce nearly three-fourths of the world's supply, mostly in the northern part of the Mississippi basin. West of the corn belt is the great wheat-producing region of the plains—western Oklahoma, Kansas, Nebraska, and the Dakotas—where the rainfall is generally too light or too irregular for corn production.

In forest resources the United States was once richly endowed, with 820 million acres of forest lands on which was growing some of the finest timber in the world—pine, spruce, fir, and a wide variety of deciduous trees. At first these forests were an obstacle to farming, but they afforded cheap lumber for fuel, houses, furniture, barns, and a great many industrial uses.

In the variety and abundance of her mineral resources the United States leads all other countries, with the possible exception of Russia. The United States has about half the world's reserves of coal, perhaps the most important of all minerals. She had originally perhaps the richest, and certainly the most accessible oil and gas reserves in the world, most of the world's phosphate, and rich deposits of iron, copper, lead, zinc, silver, gold, sulphur, and bauxite. In potential water power the United States leads all other countries, and now has more than one-third of the world's developed water power.

All these rich resources might provide only a fair living for the people if the land area were divided into a dozen small countries, like the Balkan states, which maintained high tariffs to prevent free trade among the various areas. While we may take only a modest pride in the means employed to get some of our territory, like that taken from Mexico, we are at any rate fortunate in having under a single jurisdiction this wide area of land, with its variety of products and industries. Free trade over this immense territory makes possible territorial specialization, and specialization means greater production than would be possible otherwise. Economists are agreed that two of the most important reasons for the high productivity of industry and the high wages of labor in the United States are our abundant natural resources, and free trade over this large area.

Our lack of land compactness

One serious flaw in the American land economy, as in that of Canada and Australia, is lack of compactness. The rich irrigated and forest lands and the cities and harbors of the Pacific coast region are separated from the central and eastern states by a vast area of desert and range lands which constitute a serious obstacle to trade and transportation. In this arid region of the West there are indeed some sections of highly productive irrigated lands, forests on the mountainsides, vast stretches of range lands, and scenic resources scarcely excelled anywhere in the world; but the irrigated land is only a very small fraction of the total, most of the forests are poor, and the range lands support only a thin scattering of livestock. If the poor and worthless land could be taken out and if the Pacific states could be shifted about a thousand miles farther east, transcontinental transportation would be much cheaper and the country would be richer.

The waste of our land resources

Unfortunately the people of the United States have wasted their land resources with a prodigality unequaled in history. A. E. Baker has estimated that "probably a quarter, possibly a third, of the original soil resources of fully half the arable land of the nation has been lost" through the removal of crops without restoring the elements of fertility to the soil, through leaching of the soil, and, most important of all, through erosion.[7] The National Resources Board, in a recent report, estimates that there is an average annual loss of 322,000,000 tons of organic matter from the farms of the United States, over half of it due to leaching or erosion; that 35,000,000 acres of land—about the area of the state of Iowa—have been completely ruined for farming purposes; that the top soil has been nearly or entirely removed from an additional 125,000,000 acres—an area equal to that of Arkansas, Mississippi, and North and South Carolina—and that another 100,000,000 acres—three times the area of Alabama—are being seriously eroded. Nearly 500,000 farms have been ruined by erosion.

The truth is that a considerable proportion of the area of the United States, most of it in the South, is so badly eroded that it cannot support a high civilization, even now; and if erosion continues at the rate of the past for another fifty or one hundred years, much of this land will have to be abandoned for agricultural purposes, or will support a small, scattered population living in a state of abject poverty approaching barbarism.[8]

Our forests have been wasted as ruthlessly as our farming land. The original 820 million acres of forest land have now been reduced to less than 500 million acres; and of course it is generally the poorest stands that are left. The northeastern and Lake states have now been practically cleared of good virgin timber, the South is largely stripped, and the western forests are being cut rapidly. In the country as a whole, the annual cut is now five times the annual growth, and most private timber owners handle their timber with little regard for the future.

Some of the forest destruction was of course necessary to prepare the land for farming, but much of the commercial lumbering was conducted so wastefully as to bring evils which will persist for generations. Few of the lumbermen ever provided for reforestation, but left slash lying about where it would carry fires which destroyed young trees and seeds and left the ground a desolate waste. Millions of acres of forest land were so completely ravaged that they can be made to grow trees only at heavy cost, if at all, and other millions of acres have grown up in worthless brush and inferior species of trees.

Perhaps the worst results of wasteful lumbering methods are seen on the mountain watersheds, where the destruction of the forests was often followed by such erosion of the soil that little humus was left to support a later growth of timber or other vegetation. The soil washed away was deposited in the beds of rivers, an obstacle to navigation and a cause of disastrous floods; in the arid regions of the West this silt fills impounding irrigation reservoirs, reducing the supply of water for irrigation purposes and threatening the very subsistence of thousands of irrigation farmers. Rain water runs off of deforested watersheds rapidly, making floods more serious in times of heavy rainfall and lowering the level of the streams in times of drought, and so reducing the amount of electricity that can be produced by hydroelectric plants, because the capacity of such plants is determined by the minimum rather than by the maximum flow of the rivers. This condition is becoming increasingly serious in the Appalachian Mountains, particularly in the South.

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[7] R. T. Ely, *The Great Change*, p. 183.

[8] See Gerald Johnson, *The Wasted Land*.

Our mineral resources have been exploited as wastefully as have our agricultural and forest lands; and this waste is irremediable, because minerals cannot be reproduced. Perhaps coal should be considered the most important source of energy in modern industrial civilization. Compared with it, the wind and tides are nothing, and water power is of little significance. In 1937, bituminous coal supplied 48 per cent of the total amount of energy derived in the United States, anthracite supplied 6 per cent, petroleum 32 per cent, natural gas 10 per cent, and water power less than 4 per cent. In mining coal, we have wasted nearly as much as we have taken out. Except for anthracite, which may approach exhaustion within the next few decades, this does not seem an immediately critical matter, because our reserves of bituminous coal are large enough to last hundreds of years—perhaps as long as a thousand years, although the highest-grade supplies will be exhausted much sooner.

The situation with regard to petroleum is of much more immediate seriousness. Millions of barrels of petroleum have been absolutely wasted, and that which was used has been used very wastefully. Oil has been wasted through hasty and careless drilling of the wells, through inefficient refining, and through use in automobiles that require at least twice as much fuel and lubricating oil as is necessary. Estimates of our remaining reserves of this essential mineral vary widely—19 billion barrels is one recent estimate—and do not merit great confidence, but probably our oil reserves will approach exhaustion within the next few decades, possibly even sooner. When they are gone, or when scarcity of oil makes the prices of oil products much higher, substitutes will no doubt be used. There are billions of barrels of oil in oil shales, largely in Utah and Colorado, which may be mined and run through retorts to extract the oil. Coal will be liquefied and its oil content extracted. Vegetable products will be converted into alcohol, which is a satisfactory substitute for gasoline; and vegetable oils will be produced for lubrication. All substitutes for petroleum will probably be expensive, however, and perhaps for some purposes inferior in quality.

Natural gas has been wasted even more scandalously than petroleum. This matchless fuel, which should have been conserved for the housewife's range, has been allowed to escape into the air in drilling for oil, has been uselessly burned in great flambeaux, has been used in the making of lampblack, where the heat is wasted, has been consumed in all sorts of low industrial uses where the more plentiful coal might well have served. Even at the present time we are practically wasting nearly half our annual production of natural gas; and from the total that we have taken from the ground, it is doubtful if we have secured one-tenth of the utility that could have been obtained by reasonably careful use. No one knows how much natural gas remains in reserve, but some sections of the United States that once enjoyed an abundance are now forced to substitute artificial gas, and probably a few decades will see the supply dwindling toward exhaustion.

With respect to some of our metals a brief discussion must suffice. The peak of our production of gold was passed in 1915, and we seem to have passed the peak of silver production. Known reserves of copper recoverable at 9 cents a pound are estimated to last only fifteen years, but the poorer and less accessible reserves will last much longer. Depletion of lead and zinc reserves is already far advanced; "the geologists would find it hard to tell where the supplies of twenty years hence will be found." The iron ore of the incomparable Mesabi range, in Minnesota, is nearly half gone, and the rest will hardly last another forty years, although fortunately there are large amounts of low-grade ore.

The significance of all this may be seen if we consider that our high standard of living has been possible largely because of our rich natural resources of many kinds, and if we face the fact that already that standard is being threatened by the devastation of some of those resources. More than threatened indeed, for in some parts of this country we can see serious deterioration in the condition of farmers through the wastage of their lands. If we are to maintain our present standard of living long, we must conserve remaining resources carefully.

QUESTIONS

1. Which of the following are land: a Kaw valley farm, an irrigated farm, a glacier in the Rocky Mountains, a spring of clear water, a gold nugget in the earth, ether waves, moonlight, hot winds, a tornado, a virgin forest, the Atlantic Ocean, a drained swamp, natural gas, the rock used in a house foundation, wild geese? What is the fundamental attribute of land? In what sense is it indestructible?
2. An able authority in economics has ventured the opinion that if the states of New Mexico, Arizona, Nevada, Utah, Wyoming, Montana, and Idaho had been absolutely closed to settlement or exploitation, the United States would have more wealth than she now has. Could this be true? Why or why not?
3. If the Mississippi River flowed north and emptied into Hudson Bay, would the United States be as wealthy as she now is? How would the wealth of the country be affected if the Great Lakes emptied into Hudson Bay? What is one of the great obstacles to the growth of wealth in northern Russia, aside from the cold weather and short summer?
4. Explain the growth of the following cities: New York, Chicago, Detroit, San Francisco, Los Angeles, New Orleans, St. Louis, Kansas City, Toledo, Buffalo, Pittsburgh, San Diego, Philadelphia, Miami Beach, Houston, Des Moines.
5. Dense populations, unless they are rich enough to *import* meats, must generally skimp severely in the consumption of meats, must eat mostly grains and vegetables, perhaps with some fish. Why?
6. It is said that very heavy crops of certain truck products can be grown on some of the land in Alaska. Why do not more people go to Alaska to farm this land?
7. Why might a population dependent on irrigation develop an unusually high civilization?
8. Only about 1 per cent of the total land under cultivation is irrigated, yet much more than 1 per cent of our food expenditures go for products of irrigated land. How can this be? Calculate the amount that you spend each year for food products grown under irrigation.
9. The land in Louisiana is certainly more productive than that in Nevada, yet the average per capita income in Louisiana in 1940 was only $350, whereas in Nevada it was $960. How do you account for this?
10. Is the standard of living low in Japan because the land is poor? More than half the population of South and Central America have not the essentials of healthful living. Is this because of poor land, overpopulation, racial inferiority, lack of education, or what?
11. Is there anything in Germany's situation with respect to land or natural resources which would account for her industrial efficiency and her militaristic disposition?
12. Why is there not excessive production of corn as commonly as excessive production of wheat in the United States and in the world?
13. Why is absentee ownership of farms worse than absentee ownership of a city lot, or of an industrial plant through the ownership of shares of stock? Is there any social danger in the *general* tendency toward absentee ownership?
14. Name some natural resources that may be very scarce within the next fifty years.
15. "As long as we are plagued with overproduction of farm crops, we need not worry about the erosion of some of our farms." Do you agree? Why or why not?
16. Good varnish costs about $10 a gallon; most houses no longer have shingle roofs; more and more houses are built without wood door casings; the picket fences so common a generation or two ago are now seldom seen. Why, in each case?
17. What are some of the American characteristics that can be explained by reference to our history of pioneering?

Chapter 4.

Population

Significance of the problem of population

If the people of any country are to enjoy a high standard of living, the population must not be too large and it must be of good stock—it must be right in numbers and in quality.

With respect, first, to the question of the number of people, it is obvious that no matter how rich the soil of any country there is a limit to the number of people who can live well on it. If the country has mineral resources and can engage in manufacturing, exchanging its manufactured products for food products of other countries, it may indeed maintain a high standard of living with a dense population, as England has done for more than a century; but otherwise no given land area will support more than a given number of people in comfort.

History of population growth

For thousands of years man lived much like the animals, multiplying up to the physiological limit, saving only a small proportion of his offspring, and dying himself at an early age from violence, famine, disease, or from the many hardships of his life.

Practically nothing is known of the population trends of the various countries of the world before the eighteenth century, but there is no doubt that the population of practically all of them increased considerably during that century and rose even more rapidly during the nineteenth century and up to the time of the First World War. This increase was possible because of the rapid rise in industrial productivity and wealth and the rapid decline in the death rate, particularly in the last half of the nineteenth century. During the First World War the population decreased in most of the belligerent countries and also in Europe as a whole; and while the population of almost all the countries is rising, the birth rate in most of those in northern and western Europe has declined greatly since that war, promising an early stabilization of their population at probably not far from the present level.[1]

During the second half of the eighteenth century the Industrial Revolution was in full swing; commerce, industry, and national wealth, particularly in England, were growing by leaps and bounds; and an increasing population could be sustained at rising standards of living. Near the close of that century and the beginning of the next, however, the condition of the laboring classes of England became desperate because of a series of poor harvests, the exhausting Napoleonic Wars, high taxes, rapid changes in industrial methods, and an injudicious poor law which was pauperizing many of the laborers. It was such conditions that led Malthus to his famous doctrine, published in 1789, that population inevitably outruns the food supply.[2]

History of population attitudes

Malthus was not the first one to take an interest in the question of population. As Marshall said, this question "has occupied the attention of thoughtful men in all ages of the world."[3] Primitive man usually held the procreative powers in religious veneration. Among the Greeks, who were usually at war and needed soldiers for their armies, marriage was regarded as very much the business of the state, which encouraged the birth of children in many ways; yet children were sometimes "exposed," abortion was practiced, and Aristotle himself, in his famous argument with Plato, called attention to the danger of overpopulation in a communist state where the government assumes the care of children.

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[1] R. R. Kuczynski, in *Encyclopaedia of the Social Sciences*, vol. xii, pp. 240 ff.

[2] See M. M. Knight, H. E. Barnes, and F. Flügel, *Economic History of Europe*, pp. 395–398, 437, 438.

In Rome as in Greece, the government looked favorably on a high birth rate. The Roman ideal of the state involved power, conquest, and empire, which constantly called for more soldiers and more population. Marriage was encouraged, special taxes were imposed on bachelors, and special privileges were accorded parents of large families of children. Julius Caesar prohibited women twenty-four years of age who were unmarried and childless, from wearing precious metals and jewels and using litters, and he ordained that the Campanian lands should be held only by citizens having at least three children. Apparently these regulations were not very effective, for during the later Republic and early Empire there was great concern about the stationary or declining population of Rome.

With the birth of the medieval Christian church came a different attitude. The fact that Christ and many of His disciples were celibates and that Mary was associated with virginity, and probably also the preaching of Saint Paul, naturally led to much emphasis on chastity, which was thought the best state for man, although proper marriage was not generally condemned. Since the celibate state was one of greater sanctity, the priests were usually forbidden to marry, although it is recorded that some prelates did not carry their asceticism to extremes. Altogether it seems that the doctrines of the early church were less favorable to fecundity than those of any other important religion; but the church leaders were not much interested in the question of population.

With the spread of mercantilism came a reversion to a favorable attitude toward increasing populations, although the reason for this was somewhat different from that of ancient times. The Greeks, and even more definitely the Romans, had wanted many children because of the need for soldiers; the mercantilists desired many babies, partly for that reason, but mostly because a large population was thought to increase the nation's wealth. National wealth, rather than per capita wealth, was the primary concern of most mercantilist writers. Great states were being formed, and for the support of the governments of these growing states increased revenues as well as armies were needed; while, on the other hand, the growth of commerce and industry made possible the maintenance of larger populations. The views of Malthus represent a reaction from the mercantilists' attitude toward population, just as the free-trade views of Adam Smith represent a reaction from the mercantilists' attitude toward trade.

A few thoughtful men, since very early history, have recognized the disadvantages of overpopulation. Aristotle objected to Plato's communism on the ground, often urged today by opponents of socialism and communism, that the population would rise too high if people were relieved of responsibility for their own children: "The legislator who fixes the amount of property should also fix the number of children." The physiocrats in France, about the middle of the eighteenth century, held that the state should aim at augmenting the national income rather than the population, and soon afterward a number of men began to call for a similar policy.[4]

The Malthusian doctrine: analysis and criticism

According to Malthus, the population tends to increase by geometrical ratio, doubling about every twenty-five years—2, 4, 8, 16, 32, etc.—whereas the means of subsistence increases only by arithmetical ratio—1, 2, 3, 4, 5, 6, etc. Therefore the population tends constantly to outrun the means of subsistence, and is held in check by "vice and misery," which include "all unwholesome occupations, severe labour and exposure to the seasons, extreme poverty, bad nursing of children, great towns, excesses of all kinds, the whole train of common diseases and epidemics, wars, plague, and famine."

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[3] Albert Marshall, *Principles of Economics*, p. 173.

[4] On this general subject, see C. E. Stangeland, *Pre-Malthusian Doctrines of Population*.

These are the "positive checks" on population. In later editions of his work, Malthus added the "preventive check" of voluntary abstinence from sex indulgence and marriage; but in doing this he stripped his doctrine of its real significance, for to the extent that the people adopt the preventive check, the population does *not* increase beyond subsistence, and "vice and misery" and the other evils do not follow. Malthus apparently did not expect much from moral restraint anyhow, and he was strongly averse to contraception.

The Malthusian doctrine is complementary to the law of diminishing returns and is valid only to the extent that that great law is operative. If it were possible to increase the product of land indefinitely and proportionally by applying more labor and capital, the population might of course increase indefinitely without encountering the evil results of vice and misery; and in new countries such as the United States, Canada, and Australia, where the law of diminishing returns has not yet set in sharply, the population question is not of critical significance. With the Malthusian doctrine went also the subsistence theory of wages, according to which wages always tend toward the level barely necessary to the subsistence of the laborer. This theory of wages, perhaps with some qualifications, was held by almost all economic writers before Malthus, and by most economists for half a century after him.

The Malthusian doctrine has been attacked vigorously, and often bitterly, by laymen and by some economists, since the day it was published; and during his own lifetime Malthus was regarded as a sort of moral leper by some of the English churchmen. In 1848 the American economist Henry C. Carey launched an attack on both the population doctrine and the law of diminishing returns. Influenced by the fact that he saw no excess of population and no dire poverty in the United States, but on the contrary a rising standard of living as the population increased, Carey came to the conclusion that there was no law of diminishing returns, but rather a law of increasing returns as the population increases.[5]

Other criticisms of the Malthusian doctrine would doubtless receive more general sanction today. Cannan has pointed out that Malthus put too much emphasis on food, as if it were the only element in subsistence. This was the natural attitude at a time when hunger and malnutrition were still common; but today we recognize that much more than food is necessary to subsistence, and that scarcity of food is much less to be feared than scarcity of some other things—lumber and petroleum, for instance. It has often been pointed out, too, that Malthus's contrast of the geometrical progression in population increase and the arithmetical progression in subsistence increase assumes more mathematical exactness than the facts justify.[6]

As far as the Malthusian doctrine related to conditions existing at that time and in earlier times, it was doubtless valid. The birth rate was almost everywhere very high. Adam Smith said (1776) that families of as many as twenty children, of which perhaps two survived, were not uncommon among the poorer people of Scotland. Kuczynski records average families of ten or twelve children in French Canada 250 years ago, an average of six or seven children in the United States at the beginning of the nineteenth century—only a few years after Malthus wrote—and average families of seven or eight children in the Ukraine in Russia as late as 1896–1897.[7] In new countries this birth rate did not bring vice and misery, but it did so in countries already well populated, or at any rate it tended to prevent improvement in living conditions. In the fourteenth century "the population of France had reached the approximate maximum supportable by the then-known agricultural technique";[8] and the fact that the Black Death in 1348 brought a considerable improvement in the conditions of the laboring classes in England indicates that that country was suffering from the Malthusian principle. The death rate was extremely high everywhere, more than half the children died in infancy, and intermittent wars and famines took a good share of the adult men. There were 600 recorded famines in Europe from A.D. 6 to 1855.

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[5] Henry C. Carey, *The Past, Present and Future.*

[6] Cannan, *Economic Scares*, pp. 93–95.

[7] *The Nation*, November 4, 1931, pp. 485, 486.

[8] M. M. Knight, H. E. Barnes, and F. Flügel, *Economic History of Europe*, p. 194.

The logic of history has to some extent refuted the gloomy *predictions* of Malthus. During the century following the publication of his *Essay on the Principle of Population* wide areas of fertile land were opened to settlement in the Americas and Australia; new types of agricultural implements were invented, which enabled farmers to increase their production many-fold; and developments in steam transport by land and sea, and later the development of refrigeration, enabled the peoples of Europe to obtain the products of the rich new lands at small cost. Millions of Europeans also migrated to the new lands; the population of a few European countries even declined for a time, and that of many other European countries increased less than it otherwise would have done. Even in such countries as Germany, where the population increase was very great, the standard of living rose generally during the century.

Toward the end of the nineteenth century and during the early years of the twentieth, when free land had practically disappeared in the new countries, there was renewed apprehension about the world's food supply. The "high cost of living" was a common subject for discussion; and while most economists agreed that it was largely due to monetary causes, that it was merely a general rise in the price level, many people feared that our population was in danger of outrunning our food supply and that the dire results of the law of diminishing returns were upon us.

About this time, however, new forces were at work which were destined to postpone again the evil days predicted by Malthus; the most important of these forces was the development of the internal combustion engine in the automobile, truck, and tractor. This not only increased the efficiency of farmers, and of industry generally, but released for the production of food for mankind millions of acres of land previously used to produce feed for horses. The result of this revolutionary development has been to make food products more plentiful and relatively cheaper than ever before.

For the United States as a whole, and for a few of the more sparsely populated countries, overpopulation is not a present evil or an immediate danger; yet some parts of the United States are unquestionably suffering from excess of numbers. In certain sections of the South the population is too dense, relative to the quality of the land and natural resources; many of the farms are not only infertile but far too small to provide a good living for their operators; and the Malthusian results are in clear operation—poverty and malnutrition, such diseases as hookworm, malaria, and trachoma, and a high death rate, particularly among children. In twenty Kentucky counties surveyed a few years ago, the average farm was found to include only 77 acres, of which only one-fifth was in crops—entirely too little land to support properly a family of 5.5 persons. And, as usual under such conditions, the birth rate was very high. "Retarded development," as Lorimer and Osborn point out, "fosters the maintenance of excessive fertility; and excessive fertility tends to retard economic and cultural development."[9]

The evils of overpopulation

In most parts of the world the Malthusian principle is in constant, unrelenting operation today. The population of the world is now about two billion; and of this total, at least one-fourth live in abject want, misery, and degradation; at least another fourth live in pinching poverty, on the simplest food, often insufficient, with few or none of the comforts of life; another fourth also live in poverty, but with a reasonable plenty of the plainest food and a few of the simplest comforts; perhaps another scant fourth may be said to live in comfort, with adequate food of fair variety, with decent clothing, and in attractive houses. Certainly not more than one-fourth of the world's inhabitants could be said to live in anything approaching what Americans think of as comfortable circumstances.

In such overpopulated countries as China and India, not only are many people subject to chronic undernourishment, but frequent famines take a horrible toll of human life. Between 108 B.C. and A.D. 1911 there were 1828 famines in China; and in 1920–1921, and again in 1928, millions of Chinese were reported starving as the result of several years of drought. In India, ten famines between 1860 and 1900 are estimated to have resulted in fifteen million deaths. Terrible and dramatic as such catastrophes seem, they are of small consequence compared with the suffering that much larger numbers of people, half-starved and hopeless, endure all the time. The standard diet of the rural people of China includes practically no meat, eggs, fish, or milk, and sometimes not enough grain and vegetables; their chief concern is to get enough food to maintain life. Perhaps worst of all, even humane and sympathetic observers cannot help sensing the hopelessness of such a situation and the futility of relief measures, for people saved at such a time are saved only for a life of want, perhaps to be ended in another such famine a few years later. There is no real relief for a nation so overpopulated as China.[10]

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[9] Frank Lorimer and Frederick Osborn, *Dynamics of Population*, p. 185; see also an article by E. A. Ross in *New Republic*, January 9, 1924, pp. 170 ff.

Maurice Hindus has drawn a similarly harrowing picture of conditions in Russia before the Revolution.

> The brutal fact is that the Russian peasant has been starving. Try as hard as he might, he simply could not make both ends meet. Since about 1875, scarcely a year has passed but in some one or series of provinces hunger visited the peasant districts as regularly as snow, and lingered even longer. In 1891–1892 no less than thirty million peasants in the rich black soil region were stricken with famine, which resulted in the virtual extinction of many villages. True, there was a crop failure in that region in the years mentioned. But even in years of abundant yields the average peasant did not have enough to eat, or else had to contrive to live on foods that did not possess the nutritive elements the body requires. In 1899, 1902 and 1906, famines on a large scale again assailed many peasant districts, and devastated many villages. . . . Because of such living conditions disease is rampant in the Russian village, and the death rate is appallingly high, more than twice that of the United States. Smallpox, typhoid, croup, diphtheria, dysentery, invade the Russian village with cruel regularity, and exact a heavy toll from the peasant population, especially from children.[11]

A few years ago there was considerable discussion as to whether England was not suffering from overpopulation, and an official British report in 1928 suggested that the loss of foreign markets had so reduced the demand for English goods that the country could support its former population only on a reduced standard of living. There may indeed be serious doubt whether England will ever regain her nineteenth-century preeminence as the "workshop of the world"; and it seems certain that the English people, like those of practically every other country in Europe, could live better if there were not so many of them.[12]

The evil effects of overpopulation are not confined to the physical hardship resulting from it. People who are too poverty-stricken to enjoy physical comfort are usually subject to diseases, not only those caused by malnurtition, hard work, and exposure, but those contracted through lack of proper sanitary provisions; and the death rate is high, particularly among babies and younger children. Figures covering the period 1934 to 1938 show the following death rate for babies under one year of age, per 1000 live births:

New Zealand	32
Sweden	44
United States	56
England and Wales	57
Germany	65
Italy	103
Chile	248

The infant death rate is generally highest in those countries where the birth rate is highest; and as Taussig says, this "means simply that babies are brought into the world who cannot survive. It means suffering, with never a chance of a happy outcome. Those children who do survive and grow to mature age must face low wages and hard conditions of life; yet they in their turn marry early and procreate freely. The round of misery goes on without ceasing."[13]

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[10] A graphic picture of famine in China may be found in Pearl Buck's *The Good Earth*. Katherine Mayo's *Mother India*, while not a fair picture of Indian life, contains much truth regarding the misery of the people of India.

[11] From Maurice Hindus, *The Russian Peasant and the Revolution*, pp. 19, 139. By permission of Henry Holt and Company, publishers.

[12] *New Republic*, September 5, 1928, p. 66; M. M. Knight, H. E. Barnes, and F. Flügel, *Economic History of Europe*, p. 520; W. H. Beveridge, in *Economic Journal*, December, 1923, p. 447.

Where the disease and death rates are high, people are often hard, brutal, and mean, with scant consideration for human suffering, or even for life itself. A famous traveler tells of Chinamen laughing at the sight of a man disemboweled by the wheels of a heavy cart; and of course China has long been the land of frightful tortures, probably not because of any natural cruelty on the part of the people, but because people who suffer much themselves and see suffering constantly about them can hardly develop a sensitive attitude toward it.

With dire poverty go not only suffering and callousness to suffering, but dirt and filth, and indifference to them. The cleanliness which is next to godliness is an expensive luxury, available to only a small proportion of the people of the world. It is true that some poverty-stricken people, as for instance those of Japan, maintain a generally high standard of cleanliness, but only with great effort and sacrifice. Clean clothes, bathtubs and clean water for bathing, clean food, and even soap are too expensive to be available to the over-crowded masses of China or India, or to many of the people of Europe. Even in America many are too poor to enjoy the luxury of being clean.

Overpopulation and wars

It is often assumed that overpopulation is a very important cause of war, but perhaps it is more important as an *excuse* than as a cause. Germany, Japan, and Italy, the worst aggressors in recent years, are indeed densely populated, and they continually harp on their need for more room; but they are not more densely populated than most other countries in Europe and Asia. It is probably true that if these countries had populations half as large as they now have they would be less bellicose, but this would be quite as much because they would not be so strong as because they were less in need of room. Small countries, like small boys, do not dare to be bullies. To the extent that a dense population contributes to military power it is doubtless a cause of wars.

Unfortunately the policy of imperialism is likely to bring little relief from overpopulation. Italy, for instance, with her program of military aggression, tried to raise the birth rate by propaganda, prizes, bounties, and benefits for large families, and by special taxes on unmarried men and women. Such efforts are not likely to be very effective, but to the extent that they are they bring the very evils that the coveted colonies were designed to prevent. Even if the military adventures should be successful, it is usually not possible to induce enough people to migrate to relieve the congestion at home appreciably. The experience of Japan indicates that such migration has to be organized as a government enterprise and financed by the government, and that it is expensive. Capital must be exported with the laborers in order that they may be able to establish themselves, and it is altogether probable that the export of capital will have to be relatively greater than the export of people, which means that the home country will be in a worse plight than before. Japan has never succeeded in inducing any significant number of people to emigrate to Formosa, Korea, or Manchuria. England had a desperate unemployment situation for more than a decade, yet was unable to induce any considerable number of her unemployed to migrate to her colonial or Dominion territories.

Differences in the birth rates of various countries have sometimes caused anxiety in countries with low rates. During the period of German imperialist expansion in the second half of the nineteenth century, many Frenchmen looked anxiously across the hills of Alsace and Lorraine at the teeming population of Germany, fearful of the military catastrophe which was finally to overtake them, and the French government adopted measures designed to raise the birth rate: prohibition of public discussion of birth control, annual bonuses for each child after the second, and "family allowances"—annual payments to government employees on the basis of the number of children. There is some evidence that these various measures, reinforced by patriotic and religious appeals, were not entirely ineffective, for the French birth rate did for a time cease declining; yet Spengler is of the opinion that

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[13] F. W. Taussig, *Principles of Economics*, 4th ed., vol. ii, p. 265.

France, and probably some other nations of western Europe, face a gradually declining population—"depopulation," as he boldly puts it.[14]

Since 1900, and particularly since the First World War, the birth rate in Germany has fallen rapidly, much to the consternation of some of her military-minded leaders who saw as a future threat the spawning millions of Russia, Poland, and some of the Balkan states to the east. It has even been suggested that Hitler started the Second World War when he did because he foresaw a time when the countries east of him, particularly Russia, would become more powerful than Germany, simply through weight of numbers.

If present European birth rates are maintained for a considerable time, the population map of that continent will change greatly. With the present rates, most of the countries of western Europe would not only cease to grow but would presently begin to decline, whereas the population of Russia, with an annual increase almost equal to that of all other European countries, would almost double in fifty years. It is conceivable that within the next century, or perhaps even half a centry, the populations of England, France, and Germany might fall to 30 millions each, or less, while that of Russia might reach 300 millions, or even more. In that case Russia would probably be the only great European power. If Germany had won the Second World War she might have swept the Poles, Czechs, Serbians, Russians, and other eastern peoples out of wide areas of land in order to settle Germans there. In that case there might have been a great increase in her population. But with the loss of the war it is likely that her birth rate will fall again. This is the general tendency in highly industrialized and urbanized nations, and Germany will be a land of poverty and hopelessness for some years, as will also Japan.

There is some cheer in the fact that the birth rates of all enlightened countries have declined. In some countries the decline set in more than fifty years ago. The population of France increased only a little between 1846 and the end of the century, which suggests that the birth rate was doubtless declining before the middle of the century. The "effective fertility" of the United States began to decrease almost from the very founding of the nation, first in the industrial North Atlantic states, and later in the rest of the country. According to estimates of Willcox, the "proportion of children under 5 years of age to 1000 women 16 to 44 years of age" declined from 976 in 1810 to 407 in 1930.[15] Even in such countries as Russia, Japan, and Italy, the birth rate has fallen appreciably in recent years. In practically all countries this decline has been accompanied by a drop in the death rate, particularly that of children. In the United States the infant mortality rate per 1000 live births fell from 99.9 in 1915 to 45 in 1941.

There are various reasons for the decline in the birth rate. With the growing urbaniza-

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[14] Joseph J. Spengler, *France Faces Depopulation;* Frank Lorimer and Frederick Osborn, *Dynamics of Population*, pp. 301, 302.

[15] Walter F. Willcox, *Studies in American Demography*, p. 267. His table is worth quoting:

Date	Proportion of Children Under 5 Years of Age to 1000 Women 16 to 44 Years of Age
1810	976
1820	928
1830	877
1840	835
1850	699
1860	714
1870	649
1880	635
1890	554
1900	541
1910	508
1920	489
1930	407

tion of the people there have been a general rise in the age of marriage and an increase in the proportion of the people who never marry. Probably more important is the spread of the practice of birth control. At various times in history mankind has employed different methods of keeping down numbers when necessary —the killing of the old and infirm, infanticide, particularly of girl babies and weaklings, even cannibalism occasionally, abortion, enforced celibacy, and finally birth control. A gradual humanization and refinement of this process are observable here, although abortion is still practiced, and some of the cruder methods of population control are still in use by primitive peoples.

The future population of the United States

Our total population is still increasing, but the percentage of increase has been falling; some authorities believe that the population will become stationary within a few decades, and a few even predict that it will then decline. Such a situation would give many American "boosters" a terrible headache, but there is no reason why a slightly declining population should be considered a national calamity. No matter what the future population of the country, the age distribution will change. There will be fewer children and more middle-aged and old people than at present, and a greater demand for old-age pensions.[16]

Optimum population

There has been considerable discussion of what is termed the "optimum population" for the United States, this term referring to the density of population that will yield the largest per capita production. It might seem at first thought that this would be a sparse population, since the fewer people there are in a given area, the more natural resources per capita they have at their disposal. Such a sparse population would, however, lack to some extent the advantages that come with population density: some goods that can be made cheaply only for a very large market; some transportation facilities which could not be operated profitably for a much smaller population; some cultural and recreational agencies, such as schools, hospitals, museums, theaters, and musical organizations. It is not at all certain that the people of the United States would live better if the population were smaller.

As far as food for the people is concerned, there need be little concern for the indefinite future, even if our population should increase greatly. There will be food enough, of healthful character and of excellent variety. By substituting to some extent such foods as milk, cheese, nuts, vegetables, and fruits for meat, we could easily double our food supply without reducing the healthfulness of our diet. We could exchange some of our products for certain tropical products, such as copra, bananas, and cassava, and so tap an almost limitless supply of good foods. We are already doing some of these things. It seems likely, furthermore, that chemists will find food substitutes and ways of economizing on our scarcer foods, or even means of making human food from inorganic substances. Only a rash man would set limits to the achievements of chemistry. And finally, we can greatly increase the productivity of our land by more scientific fertilization and cultivation. Our food problem would not be serious, even with a population of 200 million or more.

As to clothing, somewhat the same may be said. We could produce much more cotton than we have produced in the past, and we have usually exported about half our production. We could make more of our cotton into rayon, silk we have always imported anyhow, and nylon and other chemical fabrics will be more plentiful. We have never produced enough wool for domestic requirements, and hence should have to increase our imports—which would call for increased exports of something else. It would not be difficult to clothe a considerably larger population than we now have.

As to housing, the situation is perhaps a little less cheering; yet for some time to come we could house a considerably larger population without difficulty. Cutting each year five or six times our annual growth of timber, we face a scarcity of lumber within a few decades, even with our present population; but we can make brick and cement as long as we have coal. The metal for plumbing and heating will be available as long as our ores hold out. Shingles can be made from a wide variety of materials in practically any amount.

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[16] See an article by Joseph J. Spengler, *New Republic*, September 3, 1930, p. 61.

With respect to some of the other necessities, comforts, and luxuries of life, we must take a somewhat different view. Could we supply gasoline and natural gas, automobiles and railroads, for a population of 200 million? For a time we probably could, but we would of course exhaust our resources sooner.

Thus in conclusion we may say that although in most of the world the Malthusian principle is in operation, and overpopulation is a cause of much poverty and misery, in the United States as a whole we need not fear such a condition for any predictable future.

The quality of the population

For the United States, the concern must be for the *quality* rather than the quantity of the population. If the people are to enjoy a high standard of living, the quality of the population must be high—physically, mentally, and morally. There has been much apprehension on this point. Many writers have expressed alarm at what they regarded as the inevitable decline of the quality of the people because of the influx of "inferior" races and peoples and the high birth rates of some of these and of the "unfit" classes in general.

Ours a heterogeneous population

The population of the United States includes immigrants and descendants of immigrants from many different countries and of many different races. Great Britain, Ireland, Germany, and the Netherlands have contributed nearly 75 per cent of our present white population, Great Britain greatly predominating. Poland has contributed slightly over 4 per cent, Italy less than 4 per cent, Norway and Sweden together less than 4 per cent, and France, Czechoslovakia, and Russia somewhat less than 2 per cent of our total white population. The French influence has been somewhat augmented in recent years by a considerable immigration from French Canada, and in 1930 French Canadians constituted 14 per cent of the total foreign-born population of New England. In 1940 the total foreign-born white population of the United States was nearly 11.5 million, or 8.7 per cent of our total population. It is estimated that there are more than 4 million Jews in this country, comprising 3.58 per cent of the entire population. The Jewish people are mainly city dwellers; they make up nearly 30 per cent of the population of New York City, and 11 per cent of that of all cities of 100,000 or over. Their influence in business, as in the fine arts and in most lines of intellectual achievement, is out of proportion to their numbers.

The Mexican population in the United States has been increasing so rapidly in recent years as to cause considerable concern. There were 700,000 Mexicans in the country in 1920, and ten years later this had increased to 1,400,000, the increase coming partly from immigration and partly from a high birth rate. The Mexicans have aroused less hostility than the Orientals, especially the Chinese and Japanese, because they have not generally aspired to landownership or to leadership in business; but no one who has studied recent agricultural tendencies in the West and Southwest can escape the belief that a serious population problem is developing there. Many of the beet sugar growers use mostly Mexican laborers to cultivate the fields.

The Orientals, who have caused so much public discussion and international friction, constitute altogether only one-half of one per cent of the population, but their habit of saving money and buying land has brought the active hostility of the whites, particularly in California, and their high birth rate suggests that they may become a more important element in the future population.

Negroes present the most serious race problem now facing the people of the United States. It is true that Negroes constitute a declining percentage of the total population—19.3 per cent in 1790, 14.1 per cent in 1860, and 9.1 per cent in 1940; but, although efficient workers, they are the victims of a strong race prejudice which generally prevents them from following any but the most menial callings. Greatly outnumbering the whites in some parts of the South, they are usually prohibited from voting there, often from acquiring an education; and any advance economically or culturally is viewed with apprehension and distrust by the ruling whites. In recent years many Negroes have migrated to the northern cities where wages are higher, but there the same perplexing race issues arise.

Most of the foreign races and stocks in the United States have higher birth rates than do native Americans. The number of children under 5 years of age per 1000 women aged 20 to 44 for different races in the United States has been estimated for 1930 as follows:

White	481
Negro	497
Mexican	906
Indian	924
Chinese	1051
Japanese	824
Filipino	1090

In 1940, the birth rate per 1000 females was 51.0 for whites and 60.4 for all other races, and the infant mortality rates were also higher for all other races—73.8, as against 43.2 for whites, per 1000 live births. The birth rate has as a rule been highest among the people who came from agricultural countries, and among Catholics, as for instance French Canadians and Italians. Present conditions of living, however, seem more important than ethnic origin or remote national background in determining the size of families.[17] For most foreign-born peoples the birth rate tends to decline, with longer residence in this country, toward the level of the community in which they find themselves. This long-run tendency is of course more important than the birth rate of the first generation of foreign-born who become "native" in the second generation.

The notion of race superiority

The United States is a great racial melting pot, and one of the first questions to arise is whether, irrespective of the quality of races, a mixture of different ones is likely to produce a strong race or a mongrel race of inferior quality, perhaps inferior to both parent races. Animal breeders rely largely upon purity of stocks; the better breeds of animals are the result of careful inbreeding. Some eugenists insist that the same principle should apply to people, that the pure races of humans are the best, and that the American melting pot can only bring forth an inferior racial amalgamation. Unfortunately for this argument, it appears that there is no really pure race. Even the Jews have many strains of blood in their veins.

The question of racial superiority is fraught with grave uncertainties. There is the initial difficulty of choosing standards of excellence. The English have contributed greatly to human civilization through their colonizing enterprise and their business leadership; but the Germans and Italians have made vastly greater contributions to some of the fine arts, particularly music. Some Americans who are largely of Anglo-Saxon blood have a somewhat contemptuous attitude toward Mexicans; yet a few American cities which have a considerable population of Mexicans, as for instance San Antonio, are delightful places in which to live. The civilization of Mexico has a fine quality of its own. Negroes are not so well adapted to an industrial civilization as the white race, but they have a carefree cheerfulness under adverse circumstances, a spontaneous gaiety, a genuine love for the simpler forms of music, and superior histrionic talent, as yet largely undeveloped. In general, intelligent men do not talk much about race superiority.

The tendency of modern thought is to emphasize environmental influences more, and natural racial differences less, than formerly. A savage in his harsh natural environment in Africa, the Negro often achieves high distinction in our American universities, in spite of poor home surroundings and economic status. No one knows just how much talent the black race might develop if it could be given the most favorable physical and cultural environment. Franz Boas at any rate is of the opinion that it cannot be shown that any race is, on account of its hereditary character, unable to participate in any one of the existing civilizations; and Lorimer and Osborn consider it "wise absolutely to reserve judgment about the comparative hereditary capacities of large racial groups."[18]

Even if we discard all notions of race superiority, we may well believe that the heterogeneity of racial stocks in the United States is in some respects unfortunate. In the first place, some of the alien races in America are slow to be assimilated. The Germans, Irish, and Scandinavians of our earlier immigration soon adopted the language and manners of the new country, married into American families, and largely lost their racial identity; but more recent types of immigrants, such as the Russian Jews, Italians, and Mexicans, have been very slow to be assimilated. They form colonies in which they speak their own language, read their own newspapers, and hang rather tenaciously to their own customs. From some points of view this is of course unfortunate, although Abraham Flexner points out that the preservation of the cultures of these racial groups lends variety to our cultural landscape.

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[17] Frank Lorimer and Frederick Osborn, *Dynamics of Population*, pp. 43, 50, 53.

[18] *Ibid.*, p. 252.

In the second place, the problems of government are no doubt complicated by the racial heterogeneity in this country. With so many different nationalities and ideals represented, it is more difficult to work out policies that will be generally satisfactory to the people. In such a country as Sweden, where the people are more homogeneous, there is likely to be more unity, less internal dissension, than in a heterogeneous population like that of the United States; governmental problems are simpler and more people can be satisfied with any given policy because their ideals are somewhat the same.

In the third place, and more immediately important, many of our immigrants, largely of the laboring class and accustomed to the low wage scale of foreign countries, work for less, at least for a generation, than American labor is accustomed to, and so tend to beat down wages; and these workers are often difficult to unionize. They compete with native labor not on the basis of efficiency but on the basis of standards of living, and their influence is generally to reduce the standard of living of American labor. It might seem that this reduction would be to some extent compensated for by a reduction in the population of the parent country and by a rise in wages there; but probably there is little of such compensatory effect abroad, because the high birth rate in the home country promptly makes up the scarcity of labor there. It is doubtful if wages in Italy are appreciably higher than they would have been if that country had not lost the swarms of laborers who emigrated to the United States.

The problem of "race deterioration"

The quality of the American "race" is often thought to be deteriorating, not only because of the influx and high birth rate of alien races and peoples but because of the high birth rate of the "unfit" classes within our country. Statistics of many investigators tend to show that the birth rate is generally higher for the poor than for the well-to-do and rich, higher for uneducated than for educated classes, higher for those of low intelligence than for those of higher intelligence. Some students believe that as a nation we are breeding from our culls.

That the poor tend to have large families has been observed often since the time of Adam Smith. There is evidence that in London, at least as early as 1851, the size of family varied inversely with income; indeed, a few years earlier than this, John Stuart Mill noted that prudential restriction of family size was practiced more by the middle classes and skilled artisans than by the common laborers. Almost everywhere in the United States, it appears that large families go with small incomes, small houses or apartments, and small cars. One study indicates the same general situation in rural communities, farm laborers having larger families than tenants, and tenants larger families than farm owners; but it is doubtful if the difference here is great enough to be significant.

Just what are or will be the effects of these birth rate differentials on the quality of the American population is a question of possible importance. If we grant that economic income, financial competence, is an indication of natural intelligence, there can be little doubt that the race is undergoing progressive intellectual deterioration; but there may be some doubt as to the extent that economic income is indicative of natural intelligence. That the upper classes are somewhat larger physically and have greater vitality is generally conceded, and some careful students are convinced that they are superior mentally.

Certainly it is unfortunate that the classes which are least able to bear the expense of rearing and educating children should have the most offspring, for this means a heavy burden on the parents, and usually a high death rate and poor training and education for their children; while the well-to-do and rich, on the other hand, are able to pamper their few offspring to their detriment. As long as the difference in birth rates persists, social classes tend constantly to pull further apart.

It is worth noting that in some European cities this birth-rate differential has been reversed in recent years—in Stockholm, Rotterdam, Glasgow, in Berlin, Dresden, and several other German cities before the Nazi regime—while in Paris, Hamburg, Edinburgh, and London it is diminishing, although still large. A possible reason for this may be the fact that in many European countries, until the advent of the Fascist dictatorships, there was no law against the teaching of birth control.[19]

Perhaps more disturbing than the adverse correlation of wealth and birth rate is the adverse correlation between education and the birth rate. The fact that graduates of many colleges have an average of less than two children each has often been noted. The average number of children for women college graduates, according to one study, was 1.67. Various reliable studies have shown that the percentage of college women who never marry ranges from 50 per cent or less to about 75 per cent. A study made by Mary Roberts Smith indicates that women college graduates marry two years later than relatives in the non-college group, although their fertility rate after marriage was no lower; and in recent years it appears that there has been a marked increase in their marriage rate and fertility. A study of the men and women in *Who's Who in America,* most of whom attended college, shows an average family of slightly over two children. The professional classes have, on the whole, the lowest birth rate of all.

It would be easy to exaggerate the significance of such figures. College attendance in the United States is largely a form of social activity, and it is generally those in the upper social classes who participate in it—people who would have a low birth rate anyhow. Within this class, however, it is the most alert and intelligent who try to secure an education; and in college they usually develop a few intellectual interests and new attitudes toward all human affairs, some of which are incompatible with marriage and the rearing of families.

There is other evidence, however, of an adverse correlation between intelligence and fecundity. Lorimer and Osborn cite a number of studies, all of which reveal a definite adverse correlation between intelligence—the psychologist's I.Q.—and size of family; and Haggerty and Nash, in one of the studies cited, conclude that there is an unmistakable tendency toward a "gradual lowering of the average cultural-intellectual level of the American people, as an effect of present reproduction trends among different social groups." Mental tests are probably less reliable indices of natural intelligence than some psychologists assume, and measure environmental influences rather than hereditary qualities; yet there is no doubt that mental ability and mental weakness are likely to be inherited. In his study of 1000 highly gifted children in California, Terman found that one out of every 25 was in some way related to a member of America's Hall of Fame. A few families in New England have played important parts in the intellectual life of that section for generations.

It may be that the higher intelligence which appears in small families is the result of the better care which children in the small-family group receive, rather than an indication of better hereditary endowment; but the conclusions arrived at by Haggerty and Nash are in line with common reasoning. Herbert Spencer's suggestion that there is a natural antipathy between intelligence and fecundity seems reasonable. A man of intelligent and inquiring mind, one who is interested in all sorts of things—literature, history, philosophy, economics, drama, music, and the fine arts—one who loves to study and travel, can hardly be as much interested in the biological functions of begetting and rearing children as a man of lesser intelligence with none of these other interests. Even if the intellectual man were equally interested in rearing a family, he would probably marry later and have fewer children, because marriage and children interfere with most intellectual pursuits; and he would probably compromise somewhere between children and study, as indeed he usually does. Two children are about "standard equipment" in the homes of professional men. The less intelligent man has less need for such compromise. For women, this principle would seem to work even more rigorously, for family responsibilities interfere more with the outside interests of women than of men. The choice which many able women must make between home and career need not be made by those whose capabilities are such that a career is impossible.

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[19] *Ibid.*, pp. 83, 84.

Following this general line of reasoning, we might logically arrive at the conclusion that intelligence, wherever it appears, tends to be eliminated and that stupidity and mediocrity shall inherit the earth if we wait long enough, but we might have to wait a long time.

Comparison of rural and urban birth rates lends no cheer to the picture. The birth rate declines from farms through villages and small towns to large cities. Perhaps worst of all, the highest fertility is found in large rural groups whose economic status is already low. The population of the cities would decline rather rapidly were it not for the steady streams of fresh blood from the farms. Apparently this has been true of large cities since the time of ancient Rome.

It may be important to know what kinds of people leave the farms and go to the cities, where they tend to become "sterilized." If it is the people of the highest native capacity, it means that the rural exodus to cities involves the sterilization of the best blood we have, and the breeding of our future stock from the lower-grade individuals who remain. It is unsafe to generalize dogmatically on this point, but there is reason to believe that, along with a reckless element unfitted for the steady and undramatic work of the farm, the ones who leave include many of the ablest, most intelligent, and most enterprising of the rural population. There is evidence enough to give some pertinence to Carver's warning: "No other problem is even second in importance to that of maintaining the native quality of the rural population. The rural districts are the seed bed from which even the cities are stocked with people. Upon the character of this stock, more than upon anything else, does the greatness of a nation and the quality of its civilization ultimately depend. If the native vigor, physical and mental, of the people should decline, nothing could save its civilization from decay."[20]

Rural overpopulation

Regardless of its effect on our racial quality, the high rural birth rate has unfortunate economic consequences about which there can be no dispute. An excess of farmers inevitably means low farm incomes which will persist as long as there are too many people on the farms. The average money income of farmers is normally only a little over half that of city dwellers, and the large families of farmers impose a considerable economic burden, in spite of the fact that the children usually work and partly earn their own way. Farmers have more than their share of the task of rearing and educating the next generation, and with their small incomes and poor educational and cultural facilities they can do only an indifferent job of it. Farm people spend millions rearing and educating children who finally go to large cities to do their productive work. They are in the position of making expensive gifts to the cities in the form of thousands of able young men and women, many of them well trained and ready to go to work. It is not surprising that farmers are not generally very prosperous. There is some cheer in the fact that the birth rate in most farm regions is declining, but it is still much higher than that of the cities.

George Bernard Shaw on the birth rate of the poor

On the attitude of the upper classes toward the birth rate of the poor, George Bernard Shaw has written with wit, if perhaps too much eloquence:

> But indeed the more you degrade the workers, robbing them of all artistic enjoyment, and all chance of respect and admiration from their fellows, the more you throw them back, reckless, on the one pleasure and the one human tie left to them—the gratification of their instinct for producing fresh supplies of men. You will applaud this instinct as divine until at last the excessive supply

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[20] T. N. Carver, *Principles of Rural Economics,* p. 334.

becomes a nuisance; then comes a plague of men; and you suddenly discover that the instinct is diabolic and set up a cry of "over population." But your slaves are beyond caring for your cries: they breed like rabbits: and their poverty breeds filth, ugliness, dishonesty, disease, obscenity, drunkenness, and murder. In the midst of the riches which their labor piles up for you, their misery rises up too and stifles you. You withdraw in disgust to the other end of the town from them; you appoint special carriages on your railways and special seats in your churches and theatres for them; you set your life apart from theirs by every class barrier you can devise; and yet they swarm about you still: your face gets stamped with your habitual loathing and suspicion of them: your ears get so filled with the language of the vilest of them that you break into it when you lose your self-control: they poison your life as remorselessly as you have sacrificed theirs heartlessly. You begin to believe intensely in the devil. Then comes the terror of their revolting; the drilling and arming of bodies of them to keep down the rest; the prison, the hospital, paroxysms of frantic coercion, followed by paroxysms of frantic charity. And in the meantime the population continues to increase.

Eugenics

Eugenists not only would permit the dissemination of knowledge of birth control, but some of them urge various measures to stop what they regard as the progressive deterioration of the racial stock, or offer proposals for breeding a superior race of men. Aside from the fact that a taint of class snobbery underlies some of the solicitude for the future of the "superior" classes and the fear of the coming inundation by the inferior "riffraff," there are a number of objections to the more radical eugenic proposals, such, for instance, as sterilization of some of the lower classes, or the prohibiting of marriage for those on the lowest economic level. In the first place, the more radical eugenists exaggerate the seriousness of the trend. It is quite true that the poor and the illiterate multiply more rapidly than the rich and the educated; but there are other factors that modify the gravity of our situation. The records of such spawning morons as the Kallikaks and the Jukes are often cited as characteristic of the feeble-minded; but it has not been proved that the character of these people was altogether the result of bad heredity. It is not certain that the feeble-minded multiply more rapidly than normal persons. Their birth rate is higher, but their death rate is also higher—several times as high.[21]

In the second place, the relative roles played by heredity and environment are not very well understood, and the more radical eugenists usually fail to appreciate all the complexities and uncertainties in the problem. Apparently inferior parents may have a superior child, and superior parents may have an inferior child; very brilliant or very stupid children may be born in families where nothing that can be detected in the character of either parent or of near relatives can account for this fact. According to one authority, for every feeble-minded person there are some thirty normal individuals who carry one of the genes for mental deficiency, that is, who may be called "carriers" of feeble-mindedness. And only about 11 per cent of the feeble-minded come from the feeble-minded of the preceding generation; the other 89 per cent come from normal "carriers" of the weakness. Therefore sterilization of the feeble-minded would eliminate only 11 per cent of the defective in the next generation.[22]

Even if we could wish these difficulties away, another would emerge. On what basis should we select our future stock? What qualities should be preserved and developed? The livestock breeder knows what he wants, and it is a perfectly objective quality—beef or milk production in cattle, mutton or wool in sheep, lard or bacon in hogs—and fortunately for the breeder, animals do not have votes. Furthermore, as Clarence Darrow once pointed out, man never bred an animal that could stand competition with those produced by natural selection. In the struggle for survival the razorback hog would be far superior to the Berkshire, however much man might prefer the latter.[23] Are physical qualities in man important enough to serve as the standard? And if so, should we seek tallness, or hardiness, or merely good general health? Healthy men and women are doubtless to be preferred to sickly ones, other qualities being the same; yet it is conceivable that we might breed a stock with superior physical qualities but without intellectual distinction. Not a few of the greatest intellects have functioned in weak bodies. Hitler is reported to have conceived a grandiose scheme of race improvement through encouragement of childbearing by the fit and sterilization of the unfit; but one shudders at the thought of the "superior race" that would represent his ideal.

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[21] Committee of the American Neurological Association for the Investigation of Eugenical Sterilization, *Eugenic Sterilization: A Reorientation of the Problem,* 1936. On the environmental situation of the Kallikaks and Jukes, see O. M. Mehus, "Crime—A Community Responsibility," *Northwest Missouri State Teachers College Studies,* vol. iii, no. 1, 1939.

[22] H. S. Jennings, *The Biological Basis of Human Nature.*

[23] *American Mercury,* June, 1926, pp. 129 ff.

If we use an intellectual standard in selection, what qualities should we seek? Should it be business sagacity, balanced judgment, or more emotional qualities? Any eugenic program which aimed at the selection of the economically fit, such as Carver's scheme for prohibiting marriage for anyone earning less than five dollars a day, might tend to produce a race with business judgment, but perhaps little else. Jesus, Gandhi, Shelley, Schubert, and a vast army of the greatest spirits of all time would be termed "unfit" in such a scheme. Much of the highest type of creative work is done by men who have no interest in money. Even the selection of people with sane, well-balanced minds might eliminate some of the greatest geniuses, because the line between insanity and genius is sometimes difficult to draw. Many of our greatest artists, poets, and musicians have been badly balanced mentally.

Some of the more modest proposals of the eugenists will meet with general approval: sterilization of idiots, imbeciles, and perhaps of certain types of epileptics and criminals. There are about a million feeble-minded persons in the United States, and nearly half as many insane and epileptics; and many of these, at least, should be prevented from begetting their kind. A sterilization policy like this should be accompanied by such changes in our economic life as would make it possible for individuals of exceptional promise to marry at an earlier age and rear families. The specific measures that are necessary to accomplish such a program, however, are outside the scope of this book.

Planes of living and the character of the population

Turning now to the influence of planes of living on the character of the population, we find ourselves on more solid ground than we have been treading in our discussion of hereditary influences. Food, clothing, shelter, recreation, and education—these factors have much to do with the productive efficiency of the people. The United States is relatively fortunate with respect to all of these. Most Americans have plenty of food, such as it is; most of them are fairly well clothed; and the houses in which the majority of them live are more comfortable than can be found in most other countries. With our thousands of movie houses and millions of cars, we probably have recreational facilities equal to those of any other people, at any rate if high-power drama and rapid transportation are to be regarded as the best sort of recreation; and a higher proportion of our children and young men and women are in school than is true of almost any other nation.

Yet there is no justification for complacency. It is true that standards of living are "relative"; they are viewed from the perspective of time and cannot be appraised by any absolute standard. Many of the "poor" of today, even some who are on relief, eat better food and live in more comfortable houses than did the fairly well-to-do of three or four generations ago; but a considerable proportion of our people do not have the essentials of healthful living. The National Resources Committee came to the broad conclusion that there was an "urgent need for improvement in the purchasing power and standards of living of more than half of the Nation's consumers."

Let us see just how we stand. The National Resources Committee estimated in 1939 that, among the poorest third of the people, the expenditures for food per family unit, including "unattached persons maintaining an independent status," averaged $236 per year—less than $25 per month. This is of course entirely inadequate to maintain physical efficiency. The Brookings Institution estimated that, at 1929 prices, $800 per year was required to provide an "adequate diet at moderate cost" for a family. It also found that of the non-farm families as a whole, 16 million, or 74 per cent, did not have sufficient income in 1929 to provide such a diet; while 19 million families, or 90 per cent, were not in a position to enjoy a "liberal diet"—a liberal diet being one that "would furnish adequate nutrition, a substantial margin of safety in respect to vitamins and minerals, and a satisfying variety of foods." All this may seem rather fantastic, yet it is unquestionably true that in normal times the majority of families do not enjoy a very healthful diet—do not have enough milk, fruit, and perhaps meat. Even most farm families do not have enough of some expensive foods for maximum health and efficiency; most farmers in the South are gravely undernourished. Better food would raise the efficiency of the great majority of people, including farmers.[24]

Clothing need not detain us, for most of us have enough for reasonable health requirements; yet the National Resources Committee's estimate of $47 spent for this item annually per family in the lowest third of the population indicates that a considerable proportion of our people are not adequately clothed. In housing the situation is probably worse. The Committee estimated that there were in 1935 more than 4,000,000 dwelling units "in need of major repairs or entirely unfit for use," and that among the poorest third of the people the average outlay per family for shelter—housing, household operation and furnishings—was only $178 a year. This is less than $15 a month, far less than is necessary for healthful living, to say nothing of comfort. In every city too many people live in slums where health and sanitation and aesthetic considerations can receive little attention; and only a small proportion of the farm population live in comfortable homes. Running water, electricity, and plumbing are uncommon on farms in most sections of the country.

Recreation is essential to health and efficiency, but the poorest third of the people spent only $9 a year for this purpose—movies, ball games, fairs, circuses, dances, radios and music, club dues, and the like. Clearly this is only enough for a dreary and uninspiring life. Only $16 for automobile expenses would seem worse to many Americans, but an even more serious deficiency, in its relation to health and efficiency, is the annual expenditure, by this same group, of only $20 for physicians', oculists', and dentists' bills, for medicines and drugs, eyeglasses, accident and health insurance. This is supplemented in some cases by a certain amount of free medical care, but even so, it is gravely inadequate. It is not surprising that there is much sickness among poor people, and that strength and vitality often decline rather early. "In an average year one-half of the people receive no services from a physician, four-fifths get no attention from a dentist, five-sixths receive no health examination or similar preventative service, less than four per cent of all adult persons receive an examination of any sort, and four out of ten receive absolutely no medical, dental, or eye care of any kind."[25]

Negroes suffer particularly from poverty and its attendant ills. The infant mortality rate is almost twice as high for them as for whites, and at every age their health is much worse and their death rate much higher than those of white people. In New York, the Negro death rate from tuberculosis is four times as high as for whites—and twelve times as high among children. The difference in economic status is well indicated by the fact that in New York the percentage of Negro children who work is four times as high as for white children. Such differences in the economic status and health of the two races are due not to differences in natural abilities, for there is no conclusive scientific evidence of any such differences as these, but to race prejudice and economic discrimination.

Minds need stimulus and training too, but the poorer classes of the United States spend little for these items. Fortunately, government agencies—state, local, or municipal—pay most of the cost of education; but the poorest one-third of our families spend less than $5 annually for education, and about $6 for newspapers, magazines, and books. On this intellectual provender millions of Americans are supposed to learn not only to work efficiently but to understand the grave economic and political problems inherent in a complicated capitalist system. It is not surprising if they do this only indifferently.

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[24] Maurice Leven, Harold Moulton, and Clark Warburton, *America's Capacity to Consume*, pp. 122–124.

[25] John A. Kingsbury, *Health Security for the Nation*, League for Industrial Democracy, 1938, p. 13.

Thus we find that for all our boasted wealth a fairly large percentage of our people lack adequate food, clothing, housing, recreation, medical services, and education. If we could provide these things more generously, we would have a more efficient and a happier people; but the means of doing this are not easy to find. Many of these people, for instance the sharecroppers of the South, some of the farmers in the Dust Bowl, seasonal laborers in the sugar beet fields and on the berry and fruit farms, sweated labor in city slums—indeed, a fair proportion of our worst-paid labor—are helpless in their struggle against economic odds; some of them, particularly those of foreign birth, are exploited, held in subjection by various economic and political controls. They cannot rise through their own efforts; yet not only are they a paralytic arm of our economy, producing less than they well could and gladly would if their plane of living were higher, but they are a political danger as well, for when they have votes they sometimes vote for rather fantastic relief schemes such as the Townsend plan. When the government embarks on the policy of *giving* them goods and services, it is likely to undermine their self-reliance and induce in some of them the pauper's attitude toward relief; but if their status and efficiency are to be raised, the government will need to help them to help themselves. It seems fairly evident that the government will have to clear up urban slum districts and build homes and apartments for the low-income groups; in addition, it will have to help to establish some of the poorest farmers on better farms where they can earn a decent living. It will indeed have to do much more than this; but we cannot consider the details of such a policy here. With all our vaunted wealth, we have a fairly large number of people whose plane of living is below that of many people in relatively poor countries. We ought to be ashamed of ourselves.

QUESTIONS

1. State the essentials of the Malthusian doctrine. Is there a necessary conflict between mentality and fecundity? Is there any logical connection between the law of diminishing returns and the Malthusian doctrine?
2. "I cannot understand the stress laid by economists on the necessity of checking the growth of population. Every person born into the world brings with him not only a need for goods but the power to produce these goods." Criticize.
3. Since early times, statesmen have generally favored a high birth rate. Why? J. P. Morgan, Sr., the great banker, is said to have been responsible for the federal law against the dissemination of information on birth control. Account for his interest in the matter.
4. "If the United States sends food to some of the overcrowded and starving peoples of Asia in an effort to raise their standard of living, the only result will be an increase in the numbers of these peoples, half-starved as before." Do you agree?
5. "Efforts to raise the planes of living of poverty-stricken peoples often run in a vicious circle: their incomes can't be raised much as long as there are so many of them, and there will be a high birth rate and excess of people as long as their incomes are so low." Do you agree? How would you break this circle?
6. Germany has long stressed her need for *Lebensraum* (living room) as a reason why she must have more territory. China, with a denser population and a much lower standard of living, has always been a pacific nation. How do you explain this?
7. Why is imperialism no remedy for overpopulation?
8. A student of Indian affairs estimates that the food production of India increased twice as fast as the population between 1910 and 1933. How does this square with the Malthusian doctrine?
9. If we could in some way eliminate all feeble-minded persons, how much would this reduce the number of these people in the next generation? Explain.
10. What factors in our population situation suggest the possibility that the hereditary quality

of the people may be deteriorating? What is wrong with some of the arguments commonly used to prove this?

11. Why are some white people proud of their Indian blood, whereas even a trace of Negro blood is a fatal handicap in white society? Is the Indian race superior in most ways? Do ethnologists concede that *any* race is generally superior to others?
12. Is the Negro problem an economic problem, or is it mainly one of social significance? What would you suggest as a solution?
13. Would the poor people of the urban and rural slums be helped more by better food or by better education?
14. Among registrants examined for the Army, there was a higher rate of rejection for boys from rural communities than for boys from urban communities. Is not the farm a healthy place for boys? If Tarzan had been born in New York City, would he have been so wonderfully strong and virile?
15. More than 4,100,000 of the 16,000,000 draft registrants examined during the first two years of World War II were rejected because they did not measure up to the service standards of physical or mental fitness. What do you suppose were some of the causes of this? Would the percentage of rejections have been higher in the First World War if we had set equally high standards?
16. According to certain estimates, the newcomers to our labor force (those 20 to 24 years old), who now constitute 16.1 per cent of the population, may decline to 12 per cent by 1980; the mature workers, those 25 to 44 years old, now comprise 51 per cent of the population but may decline to 46.1 per cent in 1980; and the older workers, those 45 to 64 years old, who now number about 33 per cent of the population, may rise to 41.9 per cent in 1980.[26] If these estimates prove true, what will be the effect on the cost of our schools, on the burdens of old-age pensions, on the relative production of toys and spectacles? Can this decline in the proportion of children persist until there are no children at all? What could put an end to it?

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[26] Temporary National Economic Committee, *Hearings*, Part 30, p. 17287.

Chapter 5.

Labor in Production

Labor defined

It is difficult to say exactly what part of the total population should be regarded as laborers, or as "labor," to use the common term for the general body of laborers. For some purposes it is well to have in mind only skilled and unskilled manual workers largely employed in industrial production and transportation, perhaps the lower grades of salesmen and saleswomen in merchandising establishments, and agricultural laborers in a few sections of the country. These constitute the body of labor which is most definitely "labor-minded." Most of them expect to be wage workers always, and therefore develop an interest in promoting their common interests, a definite class consciousness, and often a hostility toward the employer. In these respects they differ from most clerical laborers, foremen, and supervisory laborers, who hope to rise to the capitalist class and are therefore "capitalistically-minded" and often little concerned with promoting the interests of labor. In labor disputes it is labor in the first and narrower sense that is significant.

In a broader sense, all those who are engaged in the production of utilities should be classed as laborers—not only manual workers, but clerks, managers, farmers, entertainers, barbers, professional men of all kinds, housewives who work for their "board and keep." They all contribute utilities, in physical products or services. Since most adults are laborers in this sense, we must not think of laborers as existing merely for the purpose of production, like horses, for they are the *end* of all economic endeavor, too. They are not only productive agents but humanity itself, whose welfare we are seeking.

Relation of the labor supply to the population

The proportion of the population engaged in productive labor in any country depends on various conditions, national customs, and traditions. In some nations, such as Spain and the South American countries, there is a rather tenacious tradition that labor, particularly manual labor, is degrading; and in such countries the cult of parasitic idleness affected by the upper classes reduces the proportion of laborers. While this cult is not very strong in the United States and in northern European countries, it has some influence even here, particularly among women. Most upper-class American men are not ashamed to work, but their wives and daughters are not expected to do any but the nobler kinds of work, that is, such work as will not indicate an economic need for additional income.

Women in industry

An increasing number of women, on the other hand, are going into industry, doing work that was formerly done by men. The percentage of "gainfully employed" women has almost doubled since 1890. This is due to several causes. The development of power-driven machines in our factories has created many jobs that do not call for great physical strength. With later marriages, there are more unmarried women who can work, and with the somewhat changed attitude toward working women they feel free to do so. At one time, unmarried women or "old maids" were thought unfortunate, if not actually disgraced. In recent years this attitude has changed completely, and many women train for business and professional work as if marriage were scarcely thought of. There is much less for married women to do in their own homes. Houses are smaller and families are smaller; children enter school at an earlier age and remain longer. Labor-saving devices in the home have reduced the work of housekeeping, and many tasks formerly done by the housewives have been taken out of the home. Canned goods in wide variety are available for the table—the most important kitchen utensil in some homes is the can opener. Dining and even entertaining have been to an increasing extent transferred to restaurants or hotels. All this of course calls for money, and many women have gone into business and industry to help earn it.

This increase in the number of women who work outside the home is doubtless an economic gain if it does not result in neglect of home and children. It means an enlarged production of goods and a generally higher standard of living, fewer dependents on each wage earner, and a better life for the working women themselves. It is unfortunate that women in the lowest income groups must work outside the home, often leaving little children with inadequate care; but even here it is perhaps better that the wives should earn what they can. The tragedy lies in the fact not that such women work, but that wages are so low as to make it necessary and that the combined wages of men and women do not provide a decent living, while among people of higher income, so many women are hard-pressed for ways to entertain themselves.

Old men and the modern economy

The nature of our modern economy has robbed us of the services of a considerable number of old men who in a simpler economy could have found something to do. A century ago most people lived on farms or in small towns. On farms there are usually chores and easy tasks that old men can do; and in small towns, where life is leisurely and some of the work not very exacting, such men can generally find some work that is not beyond their strength. At present, however, a growing proportion of the people live in large cities—140 cities contained more than half of our population in 1940—and here the speed of life is much greater and there are not many jobs for old men. Because the increasing stress and speed of modern industry demands young men, it is often difficult for men above forty or fifty years of age to find jobs, particularly in times of depression. Men who are forced to quit work comparatively early in life because of inability to keep up with the speed of factory processes often represent tragic personal problems, perhaps even cases for relief, and years of valuable labor are wasted that they would gladly have rendered. The fact that such men cannot turn out the maximum output is not a good reason why society should altogether waste their services. There are *more* old men too, relatively, than there used to be. In 1850, only 8 per cent of the population was over 50 years of age, but by 1930 the proportion had doubled, and in 1940 it was 20.4 per cent. This increase in the number of old men does not indicate a corresponding decline in the vigor of our people, however, because with better living conditions and better medical facilities we retain our health and strength longer. Indeed, at every age, people are healthier and stronger than any earlier generation was.

Children as workers

For various reasons children do a smaller amount of the work done, smaller with each generation. In the first place, the proportion of children to the total population has declined from 50 per cent in 1850 to 34.4 per cent in 1940. In the second place, children do less work outside the home. Child labor laws and school laws keep them out of the factories and in school longer. In the third place, they do less work around the home than they did in the more largely rural society of earlier days. With our increasing wealth and income we do not need to call on our children for so much work; we can afford to let them play more.

The changing character of work

Work is of different kinds and demands a wide variety of qualities, physical, mental, and moral. Physical strength is much less important than it once was. The galley slaves of Roman times needed physical strength, as did almost all laborers when human muscles provided much of the power. In poverty-stricken countries, such as China and India, many kinds of work, such as pulling rickshaws or pumping water by hand or foot power, still call for physical strength. Even in the United States there are still some jobs, particularly farming, that require physical strength and endurance. Power machinery tends generally, however, to take over the heavier jobs, especially those of a routine character. Power-driven planes, saws, drills, and sanders now do much of the carpenter's hard work; mechanical cranes, levers, hammers, riveters, drills, and cutting tools have assumed most of the heavy work of the metal worker. Farmers who once had to work hard for two or three weeks every winter sawing wood can now do the same work in a day or less with a power saw, with little muscular strain.

Physical and nervous hardihood, as contrasted with muscular strength—the ability to stand up under nervous stress and strain, to preserve health with little exercise and under artificial conditions of life—this is more needed now than ever. There is a little evidence, in the rising death rate from heart disease and other degenerative diseases, that the speed and strain of life in America may be too great for our physical resources; but the statistics are not very reliable. The death rate from heart disease is indeed rising, but this may be due to the fact that this is an ailment of fairly advanced age and a larger proportion of our people live to an age where they may die of it.

Many types of work require skill and intelligence as well as physical health; and these qualities are rarer. Most laborers can attend to a routine job in a factory, many of them can develop skill, but not many can be trusted with work that calls for intelligence and resourcefulness. Farmers often have difficulty finding hired men who can be trusted with horses or expensive implements. As Marshall well says: "To be able to bear in mind many things at a time, to have everything ready when wanted, to act promptly and show resource when anything goes wrong, to accommodate oneself quickly to changes in detail of the work to be done, to be steady and trustworthy, to have always a reserve of force which will come out in emergency, these are the qualities which make a great industrial people."[1] Any social measures, whether educational or eugenic, that would raise the general standard of intelligence would greatly increase the productivity of labor.

Reliability, trustworthiness, is to some extent a matter of intelligence, yet not altogether so; and it is a quality somewhat lacking in many peoples. Some primitive people are too careless and unreliable to meet the exacting demands of a machine civilization. Like children, they are unable to persevere at any kind of work for a long time. Civilized nations differ considerably in this respect, northern peoples like the English, Germans, and Scandinavians usually being more trustworthy than those of milder climates; perhaps they are compelled to be so by the requirements of a rigorous climate. People in the United States are educated to a higher general standard of technical skill than those of any other country, and the moral qualities of steadiness and reliability are generally high; yet even here employers often find it difficult to secure laborers who can be trusted fully.

Vocational education and labor efficiency

If a country is to have high economic productivity and a high standard of living, its workers must be individually competent and efficient and they must work together in a properly functioning economy. Hence the two fundamental productive aims of education are to develop individual efficiency and to foster the social intelligence needed to keep the economy operating efficiently. The first aim is served by vocational education, the second by general education, particularly in the social sciences; but this distinction cannot be drawn very clearly.

The oldest form of vocational education was of course apprenticeship; but the development of large-scale industry, with mechanization, standardization, and specialization, reduced the importance of the crafts and of the apprenticeship which was the appropriate form of training for them. Large-scale industry decreased the amount of skill needed by the masses of the workers, but at the same time it demanded far greater knowledge and skill of those in managerial and supervisory positions. The crafts have by no means been eliminated but they are relatively less important; workers doing the common, simple tasks of the factory do not need much industrial training. It is the engineers who design and maintain the machinery, the accountants who draw up the balance sheets, the general managers who superintend the plant operations who should be highly trained, many of them college graduates.

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[1] Alfred Marshall, *Principles of Economics*, pp. 206, 207.

There are various difficulties in the way of vocational training. Adolescents at the age at which apprenticeships would ordinarily be served are likely to be in high school, where the general cultural traditions of education are usually followed, although many high schools now offer vocational courses. There is a considerable hazard, too, in training for a given kind of work, because technological changes sometimes render such training almost useless, perhaps make it necessary for the worker to train himself for some other sort of job. To mitigate the hardship of such circumstances, vocational training should be rather broad. It should not be entirely divorced from general education, for workers are human beings and they are voting citizens and hence should have cultural advantages and civic intelligence. There are some who insist that since much of our industrial work is narrowly specialized and in some respects deadening, workers are in particular need of broad cultural training. On the whole, the tendency has been to insist on a fairly general education as a prerequisite to vocational training.

The theory underlying vocational education carries some puzzling social implications. In the United States we have the democratic theory that all—that is, all white people—who want a general education and can do the work required may go to school, in fact *must* go to school for a specific number of years, or until they have completed certain prescribed years of work. This theory seems appropriate to our democratic institutions, since most (white) men and women vote and should therefore have a general education. But vocational education below the college level is often advocated for those who do not have the ability to pursue the general course—a rather aristocratic but realistic view of the educational program, which does not quite square with the principle of universal suffrage. Students whose intellectual limitations prevent them from doing high school work are not very well equipped to help decide government policies.

Vocational education received only a modest amount of attention in the United States prior to the present century. There were a few business colleges, correspondence schools, and manual training high schools, and some engineering schools at the college level, but the total enrollment was not large. In 1917, the Smith-Hughes Act provided federal subsidies for the states to promote education in agriculture, trades and industries, commerce and home economics; and later amendments added other types of vocational work carried on in continuation schools, part-time schools, and extension schools. There has been a tremendous expansion of vocational education under the Smith-Hughes Act, some of it at the college level. The tendency has been strongly toward federal and state support of such work, and little is on a commercial basis, although a few great corporations operate schools for the training of their own employees.[2]

Some authorities assert that Soviet Russia's government has developed vocational education further than any other country. Russia has a variety of schools for training different kinds of workers, in which socially useful work and general education are combined in all curricula above the primary level. The entire system is adapted to the needs of the Soviet's planned economy. It is easy to see why Russia should emphasize vocational training. She needs more industrial production badly, and her general educational problem is in some ways simpler than that of capitalist nations. She has a plan to follow, knows rather definitely what she needs for that plan, and can use strong pressure to steer students into needed types of training. As for training in citizenship, that is relatively simple too. Whereas students in a democracy are exposed to different points of view and, in theory at least, are expected to develop the power to make intelligent decisions on economic and political questions, Russian students need only accept the doctrines determined upon by the party.

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[2] See the article on vocational education by I. L. Kandel in *Encyclopaedia of the Social Sciences*, vol. xv, pp. 272–275.

The productive value of college vocational education is easily seen. Without our engineering and technical schools, the marvelous engineering achievements of the present age would have been impossible. Without our schools of medicine, our college courses in biology, bacteriology, and chemistry, medicine could never have made such remarkable strides in the prevention of disease and the saving of human life. Schools of law have similarly contributed to the legal learning needed for the successful operation of our complicated economic system, although the legal profession has not performed its functions with conspicuous success. The schools of business which have grown up in almost all American universities in the past two or three decades have not yet won the standing of the older schools of engineering, medicine, and law; yet they have contributed greatly to productive efficiency, particularly in training accountants and statisticians.

General education

General education is doubtless a great aid to production as well as a stimulus to better living. In Marshall's classic phrases, "A good education confers great indirect benefits even on the ordinary workman. It stimulates his mental activity; it fosters in him a habit of wise inquisitiveness; it makes him more intelligent, more ready, more trustworthy in his ordinary work; it raises the tone of his life in working hours and out of working hours; it is thus an important means toward the production of material wealth; at the same time that, regarded as an end in itself, it is inferior to none of those which the production of material wealth can be made to subserve."[3]

In discussing general education, both elementary and advanced, it is necessary to distinguish several different functions of such education: (1) the function of aiding economic production directly or indirectly; (2) the function of finding and developing great leaders; and (3) the function of helping students to live fuller and richer lives.

1. Education, both elementary and advanced, has done much to increase production. The simplest kind of work may be done about as well by an illiterate workman as by an educated man, and the illiterate workman may even be more contented at such a task; but much of the work of modern times demands some education. It is difficult for literate people in the present age to realize how night-dark was the mind of man before the advent of printing, how limited was his intellectual horizon, how difficult it was for him to learn new ways, new attitudes, how difficult it was indeed for him to learn to *want* to know anything new. The invention of printing was a more important factor in increasing production than the invention of the spinning jenny or the fly shuttle.

The successful operation of a complex economic system calls for broad economic intelligence. Economic productivity depends not only on the technical efficiency of individual firms, but on wise government policies; and such policies are possible only in a country where there is a fairly high level of social and economic intelligence. Here our education has accomplished little. The aim of education in the social sciences in elementary schools, high schools, and most colleges seems to be mainly to train students to conform to economic creeds determined upon by dominating economic interests, to inoculate them against thinking about important economic questions; and conscientious teachers who wish to lead their students to think critically about the important economic problems must work surreptitiously and at great danger of losing their jobs. Education of this kind is much better ordered in the Scandinavian countries, where teachers are more free to express their honest opinions and where there is a more tolerant and open-minded attitude toward critical economic questions. On the other hand, in such Fascist countries as Germany and Italy, education in this sense was virtually abandoned, with the result that the younger generation grew up without any training in economic thinking at all, and inoculated against any such process. What this may mean to the future of the world can only be guessed; but certainly if the economic intelligence of much of the world were higher, there would not be the want and hunger and insecurity that haunt so many lands today. It now seems possible that the lack of economic and social intelligence demanded by the modern complicated world may mean the loss of all human freedom, and perhaps the end of civilization itself.

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[3] Alfred Marshall, *Principles of Economics*, p. 211.

2. There may well be a difference of opinion as to the effectiveness of our educational machinery in finding and developing great leaders. No very serious efforts have been made by most colleges to encourage the unusual students discovered in the elementary and high schools, many of whom are financially unable to attend college. Referring to England, Marshall says: "It is not unlikely that more than half the best natural genius that is born into the country belongs to them [the manual labor classes]; and of this a great part is fruitless for want of opportunity."[4] If we include farmers with the manual laboring class, this would also be true of the United States, in spite of our democratic theory of education. As Marshall further states: "There is no extravagance more prejudicial to the growth of national wealth than that wasteful negligence which allows genius that happens to be born to lowly parentage to expend itself in lowly work. No change would conduce so much to a rapid increase of material wealth as an improvement in our schools, and especially those of the middle grades, provided it be combined with an extensive system of scholarships, which will enable the clever son of a working man to rise gradually from school to school till he has the best theoretical and practical education which the age can give."[5] All the older and wealthier universities have a considerable number of scholarships for the encouragement of brilliant students; but the American people have not shown much appreciation of the importance of finding and educating brilliant young men and women.

It is difficult to appraise the effectiveness of education in developing the unusual leaders, once found. Many of the great leaders of history—business, political, literary, and artistic—have had little of the advantages of formal education. One might well wonder how much Carnegie would have profited from a college course in business, how much better Shakespeare and Mark Twain could have written had they taken a Ph.D. in English. It is possible that our education irons the freshness and originality out of many exceptional minds; yet on the whole, the balance in this matter is doubtless on the credit side of the ledger. As Taussig has pointed out, all training for the arts and professions tends to become more and more systematic, and outstanding work in almost every field requires more knowledge and a broader outlook than ever before. So education becomes increasingly important, for many lines of work absolutely essential; and the standards of work required for entrance into such professions as law, engineering, medicine, teaching, and the ministry are rising steadily.

The effectiveness of education, particularly for the professions and the more important functions, would be increased greatly if children could begin training earlier in life. We have recognized the importance of this only in music. It has long been recognized that the musician must begin his training very early in life if he is to achieve real competence. Starting to train in early childhood, he learns manual dexterity, and probably a certain corresponding mental skill essential to the higher functions of the musician. This skill is probably best learned early in life, and if learned then is not easily lost. Perhaps those functions learned earliest are forgotten last, while those learned in middle life are quickly forgotten. In the common adage, "It is hard to teach an old dog new tricks." The man or woman who studies languages after reaching maturity often speaks them with difficulty. Whether this is due to an absolute decline in the freshness and retentiveness of the mind, or to the fact that most people find themselves subject to more distractions as they grow older and incur greater responsibilities need not be discussed here. Many psychologists are inclined to the view that, although skill is best acquired early in life, the power of the mind does not decline perceptibly until middle life or possibly even later; but certainly distractions increase with age, and concentration becomes more difficult. Furthermore, the boy or girl who begins training in a specific field early has more years in which to master it thoroughly.

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[4] *Ibid.*, p. 212.

[5] *Ibid.*, p. 212.

Unfortunately, specialization is likely to begin earliest in those trades which are easiest learned and therefore should require the least training. Many of the boys who drift into common labor, factory work, or even the skilled trades—work that could be learned in a few weeks or months, or at most a year or two—begin to work while still young, perhaps without having finished elementary school; whereas those who plan to practice law or medicine or engineering commonly start getting the rudiments of their special training only after they enter college. The professions demand much knowledge and require a long period of training, and it would be highly advantageous if this training could begin earlier.

Training of women generally has little relation to the work they do later and therefore, from the point of view of productive efficiency, is very wasteful. In the United States and in most democratic countries, the two sexes receive much the same training, although the work that they finally do is generally quite different. The women in our colleges often work hard preparing themselves for vocations that they are likely to drop when they marry. Most women do marry and engage in housekeeping, for which they have had little or no training at all; their college training, if they have gone to college, has perhaps sapped their energies to some extent and so tended to render them unfit for the functions of childbearing and housekeeping, or may even have given them a distaste for the routine and humdrum tasks of housekeeping. To the extent that education is really cultural, it should not be denied to women, to be sure; civilized peoples have finally come to the view that women are human beings, and not mere instrumentalities for giving men pleasure and for bearing and rearing children. Moreover, they are citizens, with the privileges and duties of citizenship, and therefore need training in intelligent citizenship. But to the extent that college education for women is vocational it is extremely wasteful. The remedy for this is, however, difficult to find and apply.

One of the most serious faults of our educational process, from every point of view, is that formal and systematic education often ends on the day of graduation. Graduated, endowed with a diploma, stuffed with odds and ends of information like an intellectual bologna sausage, perhaps also trained in thinking to some extent, the student throws his notes into the furnace, sells his textbooks, and goes forth to conquer the world, an "educated" man. Seldom indeed does he ever again pursue any systematic course of study, either vocational or cultural. The exceptional doctor or teacher may take a year off for study, but few men develop the habit of reading worth-while magazines or anything more substantial than *The Saturday Evening Post.* They usually work hard at their jobs and become more proficient; but for most of them cultural atrophy begins on the day of graduation. Education, as John Dewey has said, consists in learning to continue one's education. It should continue throughout life.

3. Education may, finally, be regarded as an end in itself, as a consumers' good. As such, to repeat the words of Marshall, "It is inferior to none of those [ends] which the production of material wealth can be made to subserve." Education for this purpose encounters no powerful economic opposition and has been carried on with considerable success. Devoted teachers have brought many pupils to a new appreciation of the riches of music, art, literature, and philosophy, to a broader outlook and a finer attitude toward life. Notwithstanding all the cynical gibes at American college students, there is no denying that many of them have developed sufficient culture to enable them to live better if not happier lives. Almost never do we hear college graduates express regret for the years they spent in college.

It is often said that education enables people to live *happier* lives. Happiness, however, is very difficult to define. Some philosophers insist that there is no such thing, others say it is a matter of "systematized delusions." Certainly if we define happiness as comfort and satiety and contentment, it cannot be a by-product of education, and education cannot have the purpose of making people happy. The aim of education, as Frank Knight says, "is certainly not to make anyone happy; its aim is rather to raise problems than solve them; the association of sadness and wisdom is proverbial, and the most famous of wise men observed that 'in much wisdom is much grief, and he that increaseth knowledge increaseth sorrow.' "[6] For happiness we must go not to the wise men but to the uneducated and simple-minded. For examples of complete happiness we may picture a million Germans (a few years ago), with their brains turned off, yelling, "Heil Hitler"; twenty thousand students throwing their hats in the air when the home team makes a touchdown; or ten thousand patriotic Americans at a political rally, with bands and ballyhoo, saving America from God knows what. Education does not make people happy, nor does civilization itself.

Religion and economic productivity

Religions have greatly influenced economic ideals and economic conditions. Brahmanism, with its pessimism, its asceticism and renunciation of the world, and particularly its emphasis on caste, has doubtless benumbed the economic vitality and energy of the Indian people. The three thousand castes and unnumbered subcastes, with lines drawn not by economic achievement but by birth, constitute a rigid and static society hostile to economic advancement; and the 50,000,000 hopeless "untouchables" can have little incentive to bestir themselves for their own betterment. Although Buddhism lacks the emphasis on caste, it is similarly ascetic, fatalistic, and pessimistic, similarly unconcerned with wealth or economic achievement. Confucianism, stressing ancestor worship and reverence for parents, doubtless is in some measure responsible for the lack of economic progressiveness in China, as it is for the tragic overpopulation of that unhappy country.

Early Christianity, like Brahmanism and Buddhism, was ascetic and little concerned with the things of this world. Man must not heap up riches, for the rich man could not enter the kingdom of heaven; yet work was a duty, and the parable of the talents seemed to indicate approval of business activity. In general it is probable that early Christianity and the medieval church, through emphasis on other-worldiness, through their condemnation of usury, and through the subjection of men's minds to traditional religion, were hostile to the development of business enterprise. Yet the church was itself a considerable business enterprise; and, although it held slaves, it encouraged the emancipation of fellow Christian slaves and so tended to give free labor a dignity it had lacked.

Calvinism was a constructive force in the development of the modern attitude toward economic activity, although its influence is often exaggerated. Calvin justified moderate interest, dignified economic activities as "callings" or tasks set by God, encouraged thrift and industry, and condemned extravagance and laziness. It is hardly surprising that those lands to which these doctrines spread should have developed energetic, individualistic, and wealthy peoples.

"Hopefulness, freedom, and change" and productivity

"Hopefulness, freedom, and change" are important factors affecting the energy and efficiency of labor. As Marshall says, "All history is full of the record of inefficiency caused in varying degrees by slavery, serfdom and other forms of civil and political oppression and repression. . . . Freedom and hope increase not only man's willingness but also his power for work; physiologists tell us that a given exertion consumes less of the store of nervous energy if done under the stimulus of pleasure than of pain; and without hope there is no enterprise."[7] Slave labor has always been notoriously inefficient; and without a doubt the freedom, hopefulness, and changefulness of life in America have been important reasons for the energy of the American people. It is true that the changefulness and restlessness of American life have their bad effects, encouraging careless, hasty, scatter-brained activity; the tremendous rush and hurry of American life do not indicate corresponding efficiency, for much energy is wasted. The best artisans of England are perhaps better workmen than those of America, and some of the professions in a few European countries command a generally higher grade of ability and training than those in the United States. The mobility of the people shakes us loose from our reputations, as Marshall says, and so takes from us one of the best external aids to the formation of a high moral character. This is one of the reasons why cooperative enterprises have been less successful in the United States than in some European countries. Successful cooperation requires stability and integrity which have often been lacking in American communities.

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[6] Frank Knight, *The Ethics of Competition*, p. 32.

[7] Alfred Marshall, *Principles of Economics*, p. 194.

Many people have a notion that most laborers will work only if they have to, and only as hard as they have to. As a corollary to this, they believe that wages should not be too high because high wages will merely enable laborers to loaf more. This "slave-driver's" view of labor incentives is held by so many businessmen that we must examine it rather carefully. In doing so, we are led to an examination of some of the most fundamental and significant problems of human nature.

First of all, to what extent do people really dislike to work? Some socialists and communists assert that men do not naturally dislike to work, under proper conditions; and they bring some rather impressive evidence to support this view. Man is an active animal, they say, and finds joy in genuinely creative work; in fact, he would be bored to tears if it were not for work. Businessmen who have made enough money to enable them to retire do not usually do so; and if they do, they are often discontented and unhappy away from work. Retired farmers are often seen driving out to their farms at daybreak, hoping to find odd jobs that will make their lives seem worthwhile again. Lawyers find the battles of the courtroom so interesting that they seldom retire until their strength wanes. Most professors find their greatest happiness in their classrooms and research laboratories and are glad when vacation is over and they can get back to work. Many musicians, actors, and actresses find their work essential to happiness and remain at it long after they have accumulated enough wealth to enable them to live in leisure if they wished to do so.

Yet most of the necessary work of the world is far less interesting than that of artists and professional men, more dangerous, and more injurious to health. Some work involves great muscular strain, as for instance that of stevedores, miners, farmers, iron and steel workers, spade and shovel men—in fact, most day laborers. Some involves strain from the necessity of standing or walking a great deal, such as that of salesmen and saleswomen in stores, policemen, bellhops, elevator operators, waiters and waitresses in restaurants. Much factory labor involves strain because of the speed and accuracy of the motions required; whereas other work is so sedentary as to be injurious to health, as for instance that of bookkeepers, typists, and seamstresses. In various kinds of labor there is also a serious danger to health and life itself because of accidents, dust, heat or dampness, general exposure, and industrial poisons; and much of the work of modern society is done under conditions of dirt and unsightliness. Much industrial labor is painfully monotonous. Even the highest kinds of work are often so—a musician, for example, must practice many hours a day—but monotony is a more serious matter with industrial workers who feed machines or remove completed material from them, endlessly repeating simple operations that call only for the simplest mental reactions, deadly dull, boresome, meaningless, hardly worthy of a man. Surely it is reasonable to assume that men dislike such work.

Much of the work necessary in a modern society, finally, commands so little public respect and esteem that it would not be done except under the whip of economic compulsion. It is possible that under a different economic system much of it could be invested with dignity; but under any system some kinds of labor would be recognized as requiring no high ability, and therefore not worthy of great respect.

While we must thus conclude that much work is unpleasant and that people would not do it if they did not have to, we need not accept the "slave-driver's" philosophy of human labor. People work partly because they must, but they work more energetically under the spur of hope and ambition than of grim necessity. If it were otherwise, if the "slave-driver's" theory were valid, labor in the United States would be the most lazy, indolent, and inefficient to be found in the world, for it would be easier for a man to make a bare living in this country than anywhere else, if that were all he wanted; yet labor in the United States is about the most energetic and efficient in the world. Among some uncivilized peoples in tropical countries, men seem to want only a bare existence and will not work for anything beyond that; but the more advanced and energetic peoples do not work for bread alone. They want jam on the bread, and sirloin steak, and automobiles and radios and electric refrigerators; and they work harder for the jam than for the bread. We may look forward to higher wages and better conditions for labor with no fear of their reducing the laborers' energies.

Wages and the hours of work

Is is thus clear that high wages lead not to loafing and debauchery, but on the contrary to energetic and efficient work, and generally to better living. What of the effect of high wages on the number of *hours* of labor that will be done? Will higher wages in a given line of employment induce the laborers to work longer hours, or will the workers, now able to make the same income with less work, reduce their workday and take more time for leisure and recreation? Here again we meet our old friend, human nature. To the extent that laborers, like tropical savages, want merely their daily bread, they might well work fewer hours; but to the extent that their wants are indefinitely expansible, they might well be induced by higher wages to work longer hours. The effect of high wages on *energy* of work and on the *length* of the workday is not exactly the same. By working hard the laborers sacrifice only whatever satisfaction or avoidance of pain there may be in dawdling; by working long hours they sacrifice recreational pleasures that they might enjoy—movies, hunting, driving, perhaps even reading. Their indefinitely expansible wants will include some which can be satisfied by working longer hours and earning more money, and some which can be satisfied only with a shortened workday. In general, it is probable that the longer the workday already is, the less the laborers will be inclined to lengthen it for higher wages, because toward the end of the day there is a sharply rising disutility of labor. Also, if their wages are already fairly high, it is likely that they will be less willing to work more hours for higher wages, or even that they may wish to work less. Higher wages for the lowest-paid laborers might tend to reduce the amount of labor done by the *family,* since such wages would make it unnecessary for wives and children to work so much. But the total effect of higher or lower wages on the number of hours laborers are willing to work cannot be very great for any class of workers, and for those in factories it will be entirely negligible, because there the whistle sets the workday.

Even in farming, in business and the professions, there is something analogous to the factory whistle which prevents men from changing their routine much, as incomes rise or fall. If farmers' incomes rise with farm prosperity, the farmers may pay for their farms sooner and retire earlier, and some may retire who could not otherwise have done so; but as long as they remain in the business they are likely to put in the ordinary hours of farmers. If incomes rise, their wives may work less and the children may remain in school longer, but they themselves will not be likely to change their habits to any great extent. Somewhat the same thing is true of business and professional men. When business is good and incomes are high, these men could indeed afford to work less; but since they are being well rewarded they are likely to feel inclined to push their work with about as much zeal as ever, and to put in as many hours at it, for a prosperous business or profession must be attended to. The requirements of the business may not be much less imperious than the factory whistle.

Causes of labor inefficiency

The efficiency of industrial workmen is often lower than it should be for a number of reasons. In the first place, such work is often inefficiently ordered, by rule of thumb rather than by careful calculation. Sometimes operations are not carried on in such a way as to require the least possible effort, machines may be badly placed, workmen may be assigned to jobs for which they are ill fitted. In the second place, physical conditions in some plants are far worse than they need be, as to light, heat, dust, moisture, and general cleanliness, with the result that the workers' health suffers.

In the third place, conditions of employment are often such that the workers do not give their best energies to their jobs. Laborers differ in their attitudes, but most of them have certain desires and aspirations to which many employers have given little sympathetic attention. Most workers are not interested merely in wages. They want to have some voice in the determination of the conditions under which they work, want to feel that they are human personalities, want to maintain a certain self-respect, want even to do their work well. Like other classes, they have something of what Veblen calls the "instinct of workmanship" and are likely to resent conditions which make it difficult to do their work well. In World War II there were innumerable instances of labor dissatisfaction with plant management which prevented the men from doing satisfactory work, and a few workers even quit highly paid jobs because they were not given enough to do. Generally, indeed, they object to being driven hard, partly because of their infection with the "lump of labor theory" (the notion that there is only a certain amount of work to do, and that anyone who works too efficiently merely hastens the day when the jobs will be gone). But most workers want to do work that seems worth while and to do it well; and the modern factory system, even when management is efficient and intelligent, does not always provide the opportunity for that kind of work. The craftsman, at his best, could take fine pride in his work, for he really produced things of worth; he experienced the genuine satisfaction of skillfully fashioning and completing products that represented his own conception of worth. The old cabinetmaker found a creative joy in making fine furniture; he looked upon his completed product and "saw that it was good"—if it was good. In the modern factory, with its minute division of labor, no one *completes* anything, no one is really making anything, everyone is endlessly repeating certain minute operations that are not obviously related to the final product; and in this sort of work the "instinct of workmanship" is to some extent denied its fulfillment. When management is inefficient or unintelligent, when the worker can see that he is not performing even these minute operations to the best advantage, his work is likely to be drearier and more uninspiring.

Employers have tried out various schemes to raise the efficiency of their labor. The best known is the scientific management system of Frederick W. Taylor, a plan for applying the scientific, analytical method to the problems of industrial management. Under the Taylor system, "time and motion studies" are employed to find the most efficient way of doing given operations such as setting eyes and hooks in shoes or scooping sand into trucks. Much of the experimentation, however, relates to the broader problems of factory management. Thus standards are set up by which the performance of given operations can be evaluated, all the interrelated and interdependent processes in the factory are planned in such a way as to secure the greatest efficiency, and the experimentation and research are carried on continuously. The Taylor system, and other similar plans, have increased efficiency in some of the plants where they have been tried, but they have been opposed by most unions as schemes for speeding up work, and in general they have not enlisted the hearty cooperation of labor; they have not given enough attention to the psychological attitudes and aspirations of labor.

Personnel administration, "the science of management, or human engineering in industry," is a plan for securing greater productive efficiency by giving more attention to human forces in industry, more sympathetic consideration to the attitudes and interests of the laborers. Personnel departments of business concerns perform a considerable variety of functions: hire the workers needed, giving careful attention to their fitness for the particular kind of work to be done; try to maintain a satisfactory relationship between each worker and his job; help him to understand his task and to do it in the best way; promote health and safety programs within the plant; decide on shifts, promotions, and dismissals of workers; and, if properly organized, operate to give employees some voice in management problems that directly concern them. In many establishments such departments represent mere "window-dressing," a false pretense that the workers are given some voice regarding the conditions under which they work; but where these departments are so organized as to give employees a real voice in factory conditions they can do a great deal to enlist the workers' cooperation and so increase industrial production.

It must be conceded, however, that schemes for enlisting the cooperation of labor, however intelligently they may be designed and operated, can have little effect in many fields of industrial production. With modern technology, labor efficiency depends largely on the mechanical equipment used, and not much on the workers, who need only to keep up with machine operations.

QUESTIONS

1. About half the early settlers in the Virginia Colony were "gentlemen," and as a result little work was done and most of the colonists starved. What might have been the history of our country if most of the settlers everywhere had been this type?
2. Physical strength is needed in workers less than it used to be. What qualities are needed more? During World War II did you hear any employers complain about the character of some of their workmen? What faults were stressed?
3. If women were not allowed to work in industry would the wages of men be higher? Does the law of diminishing returns have anything to do with the answer? Would the *total* income of the people be as high as it is if women did not work outside the home?
4. Should women be given a general education? Why or why not? Does it make them better housewives?
5. In what ways may religions affect wealth production? In what ways may they otherwise affect the standard of living?
6. What difficulties would an employer face whose workers could not read or write?
7. Why should the education of laborers be rather general in character?
8. Under our present technology, mostly automatic, the efficiency of labor depends largely on the mechanical equipment used, and not on the workers. What does this suggest as to the sort of training that workmen should have?
9. Henry Ford used to say that it was good business for him to pay high wages because it increased the market for his cars. Do you agree? Why or why not?
10. Argue that from the point of view of wealth production alone, no state can afford to allow brilliant children to go without the training they need. Could you calculate the value of an Einstein, Mark Twain, Tschaikowsky, or Woodrow Wilson?
11. Suppose the people of the United States had the social and economic intelligence of the Scandinavian peoples. Would the United States be a richer and more productive nation? Why or why not?
12. As a general rule, the less training required for a given vocation, the earlier that training begins. Give illustrations of this rule. Does it seem unfortunate?
13. What kinds of laborers would work less energetically for higher wages? What classes of labor might work fewer hours if wages were raised?
14. What are some of the important functions of the personnel department of an industrial concern?

Chapter 6.

Labor Specialization

Labor specialization a characteristic of the modern economy

If every man, like Robinson Crusoe, made all the goods and provided all the services that he used, the problems of economics would be simple indeed. There would be no problems of value, of exchange, of wages, of distribution of wealth in so simple a society; in fact, about the only serious problem would be that of production, of securing enough goods to satisfy the elementary wants of the people. To picture such a society we should have to go far back of the earliest recorded history, for there was some division of labor and exchange in the earliest societies we know of.

Specialization, or division of labor, as Taussig says, is one of the great central facts of modern society. Adam Smith thought it so important that he began his first chapter with a discussion of it: "The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is anywhere directed, or applied, seem to have been the effects of the division of labour." Practically everyone in a complicated economic society like ours is specializing in some task and is dependent on the cooperative efforts of others for most of the goods and services he needs. The general tendency for centuries has been toward more intensive specialization.

Forms of labor specialization

The division of labor takes three broad forms: (1) *vocational division of labor*, such as we see in the work of the tailor, the carpenter, the farmer, and the physician; (2) *technical division of labor,* meaning the subdivision of each specialized trade into separate tasks, as for instance the subdivision of the process of making a shoe into some sixty distinct tasks, each assigned to a separate worker; and (3) *territorial division of labor,* by which we mean the specialization of different regions in the production of certain commodities.

Vocational division of labor. Vocational specialization has existed since the dawn of history, and there was, of course, division of labor between the sexes long before this. Biblical history begins with a division of occupations: "Abel was a keeper of sheep, but Cain was a tiller of the ground." In the earliest period of Egyptian history of which we have any record there were farmers, priests, miners, and workers in metals; and in ancient Babylon there were a surprising number of different occupations. Plato and Aristotle gave considerable attention to the division of labor, and Plato noted the advantage, to persons of "excessive physical weakness," of being able to do work fitted to their condition. Xenophon went even further in his *Cyropædia,* pointing out that the growth of cities made possible a more minute division of labor because in a city there were enough people who wanted various products so that a specialized artisan could maintain himself by producing only one thing. From Xenophon's account it appears that there was even some technical division of labor in Athens, one man cutting the leather for shoes, another putting the pieces together, and still another stitching them. Taussig points out how many of our modern names—Carpenter, Mason, Smith, Weaver, etc.—indicate crafts that go back into the Middle Ages.

Vocational specialization seems to have been based primarily on the *material* to be worked: workers in wood, stone, iron, leather, gold, and the like. Later there followed further specialization within each group, wood workers being divided into carpenters, cabinetmakers, shipwrights; and metal workers into smiths, molders, machinists, and pipe fitters, for example. In the building crafts, and in most lines of business such as banking and retailing, vocational specialization persists, although there is no uniform trend in any one direction. In drugstores, for instance, the tendency has been toward less specialization, for one function after another has been added until they resemble department stores in the variety of goods carried. Only a decade or two ago, the retailing of meats and of groceries was usually a separate function; today the two are generally combined in the same store. In many lines of business there is a drift toward assuming a wider variety of functions, in some cases for the greater convenience of customers, in others to provide more continuous use of the plant or for other reasons. On the other hand, the function of lending money has been split up and has gone to a number of agencies—home finance companies, automobile finance companies, mortgage companies, as well as banks—but there has been a contrary tendency for commercial banks to take on more functions.

Vocational specialization in the industrial field culminated in the craft gilds of the Middle Ages. It declined after this, particularly following the development of the factory system, which eliminated almost entirely such handicrafts as weaving and spinning and substituted the minutely divided tasks of the factory in the technical division of labor.

In the professions, narrower and more intensive specialization has been the strong general tendency. Within the memory of people now living there were men who combined such callings as law and real estate, perhaps with moneylending or a grocery business in addition. The writer once knew an old settler who in the early days of Kansas had been a lawyer, doctor, dentist, druggist, tailor, farmer, and politician. Many of the lawyers in the large cities at the present time, on the other hand, scarcely pretend to know the whole field of law, but specialize in constitutional law, corporation law, criminal law, abstract law, contract law, real estate law, or collections. Some of the large law firms include a dozen or more lawyers, each a specialist in a narrow field. In medicine, similarly, the old doctor of physic and leeches, who perhaps combined his professional vocation with the drug business and dentistry, has become more and more of a specialist. He usually must choose at least between surgery and medicine; and if surgery, perhaps surgery of some particular part of the body—eye, ear, nose, throat, or abdomen. In some of the large medical centers, such as the Mayo Clinic in Rochester, Minnesota, there are a score of medical experts, specialists in various fields of medicine and surgery. Even the ministry has seen the development of narrower specialization. Some of the larger churches hire several men who specialize in the different functions formerly performed by the pastor—preaching, social work, or work with young people. In teaching, specialization has been carried far during the past century. Herbert Spencer, whose first book was published in 1850, was able to cover much of the scientific knowledge of the time, including engineering, physics, natural history, biology, religion, education, government, economics, sociology, socialism, and ethics. Today it would require a hundred scholars to cover the same fields adequately. Only a generation ago, economists were expected to know the entire field of economics; today it is split up into a dozen or more special fields, and an able man can have a thorough knowledge of only one or two of these fields. As the amount of scientific knowledge increases, the area covered by each man must be narrowed.

The specialist in the professions today does not know less about the general field itself than the relatively unspecialized worker of some years ago; he merely has a smaller percentage of the knowledge that is available. The eye specialist today knows far more about general medicine than the doctor of fifty years ago; the corporation lawyer or the criminal lawyer knows more about the general principles of law than the relatively untrained general practitioner of earlier days; the economist is often better trained in general economics today than his predecessor a generation ago, but he knows a much smaller proportion of the total that is known. In the professions we insist up on a better general training than was possible a generation or so ago, and in addition we demand specialized knowledge and skill. For that reason, the leading professions require long and exacting training.

Vocational specialization brings important social advantages. In the first place, as Plato suggested, it makes possible the fullest utilization of different capacities, talents, and aptitudes. The man with a strong back can be a stone mason, the weaker man can be a tailor, the shrewd judge of men can be a banker, the persuasive and energetic man can be a salesman, the lover of truth will perhaps find happiness in teaching and research. Psychologists do not stress natural aptitudes as heavily as they once did. Except in the case of such special artistic talents as music, most men, given the appropriate environment and training, could probably do a wide variety of tasks about as well as the one they do, and with about the same satisfaction to themselves. Men do nevertheless differ greatly in physical strength, in mental alertness, and in inclinations and aptitudes, whether because of heredity or environment and education we need not consider here. Some laborers easily develop the skill and dexterity and judgment necessary to solve complicated problems; others seem incapable of doing any but the simplest tasks. Some can be trusted with responsibility; others are careless, helter-skelter, likely to be off on a pleasure hunt when most needed. Some men like work which brings them into contact with other people; others are happiest working alone. Most men are willing to do physical work, but a few prefer mental labor and have the capacity to do it well. Only a small proportion of the people have the ambition, industry, tenacity, and ability to follow the long course of training for some of the professions, and to do the work that such vocations involve. Vocational specialization provides congenial work for people with different inclinations.

Doubtless a more important advantage of the vocational division of labor is found in the increased efficiency that comes with practice, an efficiency which enables the worker to turn out far more products or services of a higher quality. Adam Smith long ago pointed out that a lad who made nothing but nails all his life could make them twice as fast as a first-rate smith who made them only occasionally. The expert typist and, on a higher plane, the pianist acquire almost miraculous speed and accuracy in their work; but all competent specialized workers acquire something much like these qualities. The Iowa corn farmer husking corn, the housewife paring potatoes, the bookkeeper adding long lines of figures, the mechanic diagnosing car trouble, the banker sizing up an applicant for a loan, the salesman selling a customer who had no idea of buying, the teacher of economics explaining the law of supply and demand—all are examples of the efficiency resulting from the division of labor.

This efficiency does not necessarily involve mental strain, because "practice makes perfect" and, as Marshall says, "enables an operation, which at first seemed difficult, to be done after a time with comparatively little exertion, and yet much better than before." An unskilled typist, for instance, must give her entire attention to the task of picking out the right letters, and is soon tired; but an experienced typist does this by some sort of "reflex" action, without great strain and without thinking of it at all, perhaps even while thinking of something else. The skilled pianist finds the proper notes almost automatically and can devote his attention almost entirely to the higher function of interpreting the music artistically.[1]

There are, it is true, some disadvantages in this narrow vocational specialization. In teaching, for instance, it has perhaps tended to develop experts in various lines who have little idea as to the relation of their own small fields to the general body of knowledge, little notion as to the function of the educational process as a whole. Perhaps teachers and scholars are less likely to have a broad philosophy of life than they were when they covered a wider field of knowledge. In the interests of a broader outlook for their students, many universities are trying to break up the hard and fast lines that specialists have drawn around their various fields, and are introducing "orientation courses" to give students a broader outlook than most of the professors have.

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[1] In his *Principles of Economics*, pp. 250–254, Marshall has an excellent discussion of this.

It would be easy to exaggerate the loss resulting from our narrow vocational specialization. The doctor who treats only eyes has a narrower field of knowledge and practice than a general practitioner, but he knows his field more thoroughly, he goes deeper. The jack-of-all-trades knows a little about a great deal. He is a smatterer; he knows no field thoroughly. Still worse, he does not know what it means to understand any subject thoroughly; he has not the "feel" of careful, painstaking investigation. At his worst, in the scientific field, he may even gravitate into a habit of careless, superficial generalization which verges on intellectual dishonesty. According to Durkheim, "We can then say that, in higher societies, our duty is not to spread our activity over a large surface, but to concentrate and specialize it. We must contract our horizon, choose a definite task and immerse ourselves in it completely, instead of trying to make ourselves a sort of creative masterpiece, quite complete, which contains its worth in itself and not in the services that it renders."[2]

Specialization does, however, involve a heavy loss in human happiness in some ways, because it restricts our work to a narrow range, with resulting monotony of work and lopsided development, mental and physical. Many kinds of work involve too little or too much physical exercise, or perhaps too little exercise of certain faculties. It would be most fortunate if the typist could work in a garden part of the time, instead of pecking away at her typewriter all day; if the bookkeeper and banker could exchange jobs with the farmer or carpenter occasionally. There would be fewer neurotic stenographers, fewer diabetic bankers, fewer underweight farmers. This is, of course, impossible, for under such a scheme the work of the world would not be done efficiently. But we may well look forward to shorter hours of labor, with increasing opportunity for recreation in our leisure time. This would give us the advantages of specialization and would be better in some ways than shifting from one kind of work to another, for the best relief from hard work is probably found not in hard work of another sort, but in something that has an element of play in it. As Marshall says, "Any occupation which is so far business-like that a person must sometimes force himself by an effort of the will to go on with it, draws on his nervous force and is not perfect relaxation."[3]

Specialization has the effect of increasing interdependence among the various classes of society. The pioneer did most things for himself—built his own shelter, perhaps with the help of neighbors, and produced all his own food; and his wife made his clothes. For entertainment he organized a spelling school or literary society or singing school or a prayer meeting. If he was sick he took a dose of medicine from one of the bottles he kept on the shelf, or perhaps it was whisky; if his wife was in labor, he helped her deliver her child or perhaps called a midwife. He lived a simple and meager life, but he was independent in many ways and was fairly certain of the kind of life he was accustomed to. The man in a highly specialized society is more dependent on others.

This has had some unfortunate effects on the family economy. The development of occupational specialization means that there is a specialist who can do better than the members of the family most of the things that were once done in the home. The farm home of two or three generations ago was a cooperative enterprise with jobs for everyone, including the children who helped with the lighter tasks in the field and with the chores. Each one did for himself many of the things that had to be done: the boys learned to press their own clothes; the mother and the girls made many of their own clothes, washed and ironed them, washed and curled their own hair; the father had a shoe last with which he repaired the family's shoes, and scissors and perhaps even hair clippers with which he cut the children's hair. The family's expenses were modest. This type of simple family economy has been greatly modified, even on the farms, and nothing like it exists in the cities, where more and more of the people live. In our modern economy most of the tasks mentioned, and many others as well, are now done better by specialists outside the home. But the specialists have to be paid, and here the husband and father comes in—he is a specialist in paying bills. The modern middle-class home throws a rather heavy financial burden on the breadwinner, and the other members of the family can do little to help, unless they find jobs outside the home. Here is doubtless a reason for the later age of marriage in recent years, and for the declining number of children in the average family.

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[2] Émile Durkheim, *Division of Labor in Society,* translated by George Simpson, p. 401.

[3] Alfred Marshall, *Principles of Economics,* p. 252.

Technical division of labor. The second form of specialization, historically and logically, is known as *technical division of labor,* which we have defined as the subdivision of each specialized craft into separate tasks. It is impossible to draw a clear and exact line between technical division of labor and occupational specialization, for they shade into each other. No craftsman ever carries a productive operation from the beginning to the end. The tailor buys his cloth from a manufacturer or wholesaler; the carpenter usually buys his lumber already squared and planed. On the other hand, even in some of the professions there is something analogous to technical division of labor. Medical specialists divide the body into parts and each specialist takes care of one section, somewhat as one group of workers in a meat-packing plant break legs, another cuts off hoofs, and still another skins a certain part of the carcass.

Technical division of labor developed with the growth of the factory system, and is both the cause of the use of machinery and in turn the result of the use of machines. When tasks are reduced to simple repetitive motions, they can be done more cheaply and accurately by machines than by men. Machines are more regular and accurate in their motions than men, and they do not tire. But machines, once installed, call for new lines of division of labor. By lowering production costs and prices, they make possible greater sales and therefore greater production, with a consequent demand for new types of labor—some to design, set up, and attend the machines; others to take charge of the general management of the factory; others to sell the product; and still others, largely unskilled, to feed the machines and take away finished or partly finished materials. Where machines have become fully automatic the latter tasks are largely dispensed with, and the significant jobs in the factory are those of unspecialized tenders of machines in general who set up the machines and see that they work properly.

A significant social change appears with the development of technical division of labor. In the handicraft system there were apprentices, journeymen, and master craftsmen, and the apprentices looked forward to becoming journeymen and finally master craftsmen. There was no social no-man's-land between master and journeyman or journeyman and apprentice, and no blind alley in the crafts organization. In the modern factory, however, labor is classified according to the type of skill and performance required, and this is determined by the machines. For the unskilled workers there is little chance of promotion to important and well-paid positions. The puddler in the steel mill, by virtue of high intelligence and hard work, may become a superior workman and perhaps draw a few dollars extra pay, but a puddler he will remain in all probability. Engineers, technicians, and accountants are chosen largely from university graduates, and the highly paid managerial positions are often filled by those who have influential family connections or some other sort of inside track, or they perhaps are filled by men chosen by bankers who control the corporations. Managers sometimes come up from the ranks, but that is becoming increasingly difficult; and even if they were always chosen from among the laborers, the chance of any given laborer rising to such a position would be almost infinitesimal—in a factory employing 10,000 workmen it would be one in 10,000. About the only way for most factory laborers to rise out of their position is to leave the factory and enter some small business, and this is usually impossible. Thus the factory system has brought a social caste system scarcely less rigid than that of feudalism. The laborer is not a serf, but he is generally tied to his job by imperious economic necessity, and his chance of rising out of his position is scarcely better than that of a manorial serf achieving the status of freeman.

This specialization of the work of direction, of organization, of initiative in the hands of a small proportion of the people engaged in industry is, as Henry Clay says, "perhaps the greatest evil of the modern industrial organization. It removes from the work of the great majority of people the educational element, the element that develops the highest faculties and character."[4] Marshall has pointed out that "the business by which a person earns his livelihood generally fills his thoughts during by far the greater part of those hours in which his mind is at its best; during them his character is being formed by the way in which he uses his faculties in his work, by the thoughts and the feelings which it suggests, and by his relations to his associates in work, his employers or his employees." There can be little of educational, cultural, or character-forming value in setting the eyes in a shoe, skinning the hind leg of a carcass, turning nut No. 34 on a Ford car. All the work of organization, of planning, all the work calling for initiative and broad judgment, is done by a very few men; the laborers simply obey orders, like the privates in the army. The vast difference between the functions of employer and laborer does not measure merely the difference in their natural capacities. Probably the employer has greater native ability, in the beginning, in the work of organization and management, but the ability he finally develops is partly or mainly due to the constant exercise of his faculties through many years; whereas the laborers have no opportunity to develop such abilities as they have, or may even partly lose them because of the routine character of their work. The differences in functions, in income, and in social position in our modern society are far greater than the differences in natural capacity alone would justify.

Indeed it is not certain that business organizers usually develop superior abilities with respect to anything but their particular task of organizing business in such a way as to make profits. As will be pointed out in a later connection, they are in some ways among the narrowest of men. Their social intelligence, as revealed by the pronunciamentos of such businessmen's organizations as the National Association of Manufacturers and the United States Chamber of Commerce, is probably lower than that of many labor union members. The function of "making money" appears to make men narrow in some respects. On the other hand, some laborers, in spite of the routine character of their work, develop fairly broad economic and social intelligence, perhaps because of their daily contact with other laborers in the factory, perhaps because their unhappy economic status impels them to think seriously about economic and social questions. The division of labor which restricts their productive energies to a narrow range also encourages them to study the relationship of their own work to that of others, including the directing staff; that is, it encourages them to study some of the broad, fundamental problems of economics. As Clay says, "The general intellectual keenness of some of the [English] mill towns might put some universities to shame." But obedience, docility, apathy in asserting their own interests—these are the marks of ideal laborers from the employer's point of view, the qualities most likely to bring employment. Aggressive, individualistic laborers are likely to become "troublemakers" and to find it difficult to secure employment.

The loss of initiative on the part of the laborer and the lack of opportunity for assuming responsibility are not evils for all, for there are many people who lack strong initiative and dislike responsibility. There are fewer such people among laborers than employers usually assume; yet there are certainly many workmen who would not assume responsibility even if they had the opportunity.

Territorial division of labor. The third form of division of labor, territorial division, refers to the specialization of certain geographic regions in the production of particular products: of Pittsburgh in the production of steel, for instance; of Paterson, New Jersey, in silk goods; of Troy, New York, in shirts and collars; of Lynn, Massachusetts, in women's shoes, and of Brockton in men's shoes; of North Carolina in cigarettes, southern California and Florida in citrus fruits, Kansas in wheat, Iowa in corn. Territorial division of labor may be international, as we shall see in a later chapter.

Territorial division of labor is based on various factors: climate, soil, mineral resources, raw materials, transportation facilities, markets, or perhaps on more superficial and changeable factors. In agricultural production, climate is of course a basic and unalterable cause of specialization. In the United States, citrus fruits can be grown only in states with a semi-tropical climate, mainly in Florida, Texas, Arizona, and California; sugar cane demands a similar climate; corn, the most important of all our grain crops because it is the basis of much of our livestock production, calls for a temperate climate with dependable summer rains and warm nights; wheat can be grown where the summer rainfall is insufficient for corn growing, as in Kansas and the Dakotas; cotton demands a fairly warm climate with long summers; apples can be grown in colder regions.

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[4] Clay's discussion of this point, in his *Economics for the General Reader*, p. 40, is one of the best to be found anywhere.

Climate is of some importance in other industries than agriculture. Hollywood is the center of the moving-picture industry of the United States, and to some extent of the entire world, partly because the sunny and equable climate of southern California permits more days of work than would be possible in more humid regions. San Diego is an important center for aviation training for the same reason. One of the reasons for the shift of the American textile industry from New England to the South has been the lower cost of living and lower wages in the South, lower partly because of the mild climate.

The character of the soil is important mainly in agricultural specialization. The deep, rich soil of Iowa and Illinois is one of the important factors encouraging corn production; the sandy soil of the Kaw valley in Kansas encourages specialization in potatoes and melons; the poor soil and lack of good grass in much of the South partly account for the fact that forestry is the important industry, rather than livestock production or dairying; and the poor soil of most of New England has been one of the factors that have forced the people into industry.

Mineral resources, particularly fuel resources and raw materials, are the basis of much regional specialization in industry. In a few instances the fuel and raw materials are found in the same vicinity. Around Birmingham, Alabama, there are deposits of coking coal, iron ore, and limestone which provide the basis for an efficient steel industry. The iron deposits of Minnesota and the coal deposits of the Lake states to the east are far apart, but the Great Lakes provide cheap water transportation from one region to the other. A great steel industry grew up first at Pittsburgh, where the coal is mined, the ore from Minnesota and Michigan being hauled to the source of the coal; but later some coke was hauled to the source of the ore as a return cargo for boats, and an industry was built up at Duluth, on the extreme point of Lake Superior.

The extent to which industries must cluster around sources of fuel, power, or raw materials depends upon a wide variety of factors. The mining must of course be carried on where the fuel resources or mineral raw materials are; but the manufacturing may be done there or at a distance which will be determined by various factors centering largely around transportation. If transportation were efficient and absolutely costless, industries might be established almost anywhere. Diamond cutting is an illustration of this. Diamonds are so light in proportion to their value that transportation costs are negligible, with the result that, until the outbreak of the Second World War, most of the diamonds mined in South Africa were cut in Europe, largely in Belgium. Steel production, on the other hand, calls for much fuel and iron ore, both bulky products, and must therefore be carried on near the source of one or the other of these necessities. Lumber manufacturing must similarly be carried on near the source of the logs, which are too bulky to be carried far. It is cheaper to haul the finished steel and lumber from the mills to the consuming centers than to haul the coal and ore or logs from their source to the mills. The cement industry developed first in the Lehigh valley in eastern Pennsylvania, where there is cheap fuel and raw materials—limestone and clay or shale—but it has since spread widely, even to regions where there is no coal.

A wide variety of industries engaged in fabricating such raw materials as steel and lumber into finished products may be located almost anywhere, perhaps at or near the point of consumption. Some raw steel, for instance, is made into tanks and boilers in Kansas City rather than at the steel mills in Joliet or South Chicago, because it costs less to transport the steel plates to Kansas City than the finished products. Similarly, many oil refineries are located far from the oil fields, because it is cheaper to transport the crude oil through pipe lines or by ocean tankers than to ship the gasoline by rail. New Jersey, without any petroleum production, in 1932 had a greater refining capacity than Oklahoma. Much of the Texas crude oil is shipped by tanker to the great Bayonne refinery in New Jersey. In recent years several gasoline pipe lines have been built, and they have tended to shift some refining back to the oil fields.

In the meat-packing business the tendency has been toward a decentralization of plants, with a shift out toward the sources of livestock supplies. Such packing centers as Chicago, St. Paul, Cincinnati, Kansas City, and Omaha do not have the relative importance that they once had, for small plants have been built at many points throughout the regions which produce livestock. The reason for this is in considerable measure the improvements in refrigerator cars and the speeding up of freight trains, which make possible the shipment of dressed meat without deterioration. The location of our flour mills depends largely on the relative cost of shipping wheat and flour, although other factors are important too. At one time much flour was produced at small grist mills scattered throughout the producing area; but almost all these mills have been abandoned—driven out by the superior efficiency of the large mills, which could obtain two or three times as much high-grade flour from a given amount of wheat as they could.

Thus transportation conditions are very important in determining the location of industries. Any change in the speed, efficiency, or cost of transportation tends to cause shifts in the location of industries. The development of truck hauling has brought great changes during the past two or three decades.

In some cases industries grow up in certain localities without any particular reason geographically, perhaps because certain enterprising individuals happened to establish them there, long ago. The great glove-manufacturing industry at Gloversville, New York, was originally started by some Scotch glovers who settled there in 1760; a working woman in 1830 initiated the collar industry at Troy, New York, which grew to dominate the field in the following century. There is no particular geographic reason why a great tap and die industry should have grown up at Greenfield, Massachusetts, or a hosiery industry at Cohoes, New York, or why cheap jewelry should be made at Attleboro, Massachusetts, or hats at Danbury, Connecticut. Various other locations would have been as good. But in one way or another the industries *happened* to be founded in a certain place, and prospered.

Once an industry has become well established in a given locality, it tends to stay there and to grow. The entire community learns a great deal about the business and the children pick up information unconsciously, with the result that there are many skilled laborers in the community, and children who can easily acquire skill. Subsidiary trades and industries grow up, using expensive and efficient specialized machinery; trade journals are published which broadcast useful information to the various concerns in the trade; buyers come to the community to buy because they know they can find ample supplies and a wide variety of goods there.

There are some disadvantages in such specialization. A district which is dependent mainly on one industry may be subject to extreme depression in case of a serious decline in the demand for its product. Also it may not provide a market for all the kinds of labor available there. For instance, a locality whose industry is confined to steel production offers little opportunity for the employment of women and children. In many cases other industries have been established in such places, industries in which women and children can work, with a resulting increase in the average family income.

Analogous to the territorial division of labor is the localization of various kinds of business in certain parts of cities. Retailing is usually carried on in the most congested part of the city, banking and investment functions in a district just outside the retail center, automobiles and automobile supplies in some other section, wholesaling still farther out, manufacturing in the outskirts of the city or perhaps at some distance away, and truck growing on the farm land immediately surrounding the city. Some cities afford examples of even more intensive specialization: "medical centers," with large buildings devoted mainly or entirely to doctors' offices, various related services being provided in the same building; and "legal centers," buildings given over to law offices, perhaps with a central library of lawbooks.

Regional specialization within a city offers great economies not only to the businessmen themselves but to the general public. The economies available to businessmen are somewhat similar to those arising from regional industrial specialization. The general public enjoys many economies. Thus it is convenient and economical for shoppers to be able to go to the important retail stores with a minimum of effort; for investors and speculators to have the banks and financial institutions grouped together in one district; for retailers to be able to reach wholesalers with the least possible trouble and expense; for the sick or injured to have every necessary medical service available in one building.

QUESTIONS

1. Estimate the number of people who participate directly or indirectly in providing your dinner.
2. The home is in many respects a very inefficient enterprise. Why?
3. Is there any more cultural development in the work of a general physician than in that of an eye specialist? In teaching a course in Shakespeare than a course in general literature? In what respects do workmen in watch factories have pleasanter work than the handicraftsman who used to make watches?
4. The work of a farmer is not highly specialized. Is it more interesting than the work of a man or woman who sets eyes in shoes all day? Is the latter's work more interesting in any way? The work of a housewife is also unspecialized. Do you think it is interesting? Why or why not?
5. "The difference of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown to maturity, is not, upon many occasions, so much the cause as the effect of the division of labour. The difference between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise, not so much from natures as from habit, custom, and education." Would a modern psychologist agree with this statement by Adam Smith (*The Wealth of Nations*)?
6. Field believed that the narrow specialization and high concentration necessary for success in modern life often require the sacrifice of those well-rounded qualities which are most needed for parenthood and a full life, and that the devotion which family life calls forth cannot in turn command an economic price in the market place. Do you agree? Do fathers spend enough time with their children, usually?
7. What are some of the causes that have led to localization of industries? Why do miscellaneous industries go to the large cities?
8. How do you account for the scattered moderate-sized packing plants and flour mills in Kansas? Why are they not concentrated in the big cities? Why did the many small grist mills of a generation ago disappear?
9. Division of labor is bound up closely with the exchange of goods. Explain how.

Chapter 7.

Capital and Durable Goods

Capital defined

In a sense, as Marshall says, there are only two agents of production, nature (land) and man; for capital is created by man. Yet capital is so important in modern production that it is necessary to consider it a third factor of production. The vast increase in the amount of capital over the past century or more is an important cause of the remarkable rise in the standard of living.

There are many different conceptions and definitions of capital. To the businessman it usually means a fund of purchasing power, or perhaps the amount invested in a business. We have already defined capital, however, as *the man-made goods used not for the direct satisfaction of wants but for the production of other goods.* A shorter definition, quite as serviceable, is *the man-made instruments of production*—"man-made" to distinguish it from land, which is also an instrument of production but is provided by nature. We should include in the term capital such goods as the farmer's plow, reaper, barn, granary, horses, and cattle; the businessman's factory or store building, machines, trucks, the showcases in the store; the lawyer's office and office equipment, including his library; the delivery boy's bicycle, the lumberman's ax, the housewife's needle. These are all used not to afford direct satisfaction but to produce other goods which satisfy wants, or to produce other capital with which to produce the final consumers' goods.

Free or floating capital, and specialized capital

Economists often classify capital as *free* or *floating* capital, and *specialized* capital. Free capital is defined by Marshall as *command over goods to a given money value, which can be applied to any purpose;* this is nearly synonymous with purchasing power. A man with a thousand-dollar deposit in a bank, according to this definition, would have so much free capital, but it would not be capital in the general economic sense. Bye has defined free capital as including capital goods which may be put to many different uses, as for instance large buildings in the heart of a city which may be used for many different purposes. This conception has the advantage of referring to capital in its real economic sense. Specialized capital, on the other hand, is capital which is adapted only to some particular use, such as a farmer's plow or harvester, a machine for making automobile fenders, a steel mill, or a grain elevator. This distinction between free and specialized capital is of course only relative, like so many distinctions in economics, and should not be pressed too far. Some capital may be used for only one function, other capital for a few functions, still other capital for many functions.

There is a general tendency for capital to become more specialized, like some kinds of labor as in the case of the professions; and while this has increased its productiveness it often shortens the useful life of the capital. Some of the tools used by glass-blowers could be employed for various operations, and so changes in the types of glassware demanded did not make it necessary to scrap many of them; but today there are great machines for turning out certain kinds of glassware which would have to be scrapped or remodeled if consumers' tastes changed. The abandonment of the breweries and distilleries at the time of the Prohibition Amendment has often been cited as illustrating the heavy loss in specialized capital when public demands change; however, it is scarcely conceivable that any change in public demands could render useless most of the well-located buildings in a large city.

Fixed and circulating capital

Capital may also be *fixed* or *circulating.* Fixed capital, represented by factory buildings, railroads, and machines, *may be used repeatedly in the same operation,* whereas circulating capital, represented by raw materials and fuel employed in industry, *is used but once or a very few times.* Bye includes as circulating capital also "manufactured products in partly finished form, and stocks of goods in warehouses and on the shelves of dealers." This may be permissible, although such goods are not strictly "instruments of production" within our definition of capital. This distinction between fixed and circulating capital, like others, cannot be sharply drawn, for fixed and circulating capital shade into each other. Coal is used only once and is quickly gone; lubricating oil lasts longer; band saws are perhaps worn out in a few weeks or a year, but the machinery that impels them may last several years; and a factory building often lasts for a generation or more.

A large and growing amount of the capital of the United States is used to produce not consumers' goods but machinery—capital. Steel mills are largely engaged in this, as are implement factories and factories for the production of trucks, tractors, spades, shovels, and the like. The capital may indeed be many stages from the final consumer. It is easy to imagine a steel furnace being used to make the steel for a steam digger to be used in digging iron ore for the production of steel for use in making saws to saw the lumber to be used in building a factory that will be used for the production of dies for use in the manufacture of automobiles. Such a sequence might run almost indefinitely. We should find that much of the country's capital equipment is necessary to secure the bananas we eat for breakfast.

Capital historically considered

Probably man has always used capital and has always had a few simple forms of durable wealth, for even some of the animals have these, although no animal ever fashions tools. The Neanderthal man, who probably lived at least fifty thousand years ago, used fire and had crude stone implements, some of which had been developed in earlier ages. It is likely that the first implements were for hunting and fishing, and among the first durable goods were those for personal adornment. Domestication of animals came later, and in the pastoral stage of history such animals were an important form of productive wealth. About this time, wells were dug, which became important capital in semi-arid countries. Later boats were built, and still later small ships for water transportation. When man entered the agricultural stage he began to apply improvements to the land, and agricultural implements were developed, but they were simple, clumsy, and inefficient.

A very important step in the development of capital came with the discovery of the use of metals. The reduction of copper ores was understood in Babylonia and Egypt nearly four thousand years before Christ; tin was used about 2500 B.C., and iron a thousand years later. The precious metals were less important, being poorly adapted to use in tools; but like precious stones they were employed as a means of hoarding wealth. Gold was used in Egypt a thousand years before the refining of copper was developed.

Such things as these—crude implements, huts, and later precious metals and precious stones; great public edifices, mainly religious, like the pyramids and ancient temples; roads, boats and small ships, canals and irrigation works—were the chief forms of wealth for many centuries. The only trade that used expensive equipment was shipping, and the ships were small and crudely built.

In the later Middle Ages, with the growth of the Italian city-states and the commercial cities of northern Europe, wealth began to increase rather rapidly; and in the eighteenth century the development of the factory system, particularly textile factories, and the growth of colonies and of international trade brought a rapid increase of productive capital. The use of water power and, later, steam power in the factories made possible a great increase in the number, size, and complexity of machines. The making of these machines called for coal and iron mines, smelters and ironworks; and larger and better ships were built in extensive shipyards for the growing traffic.

The creation of new capital continued at an accelerating pace during the nineteenth century, England leading, with the United States and the countries of western Europe following. Canal building, begun in the preceding century, was pursued on a more extensive scale; railroad construction was begun late in the second decade, to continue at a prodigious rate in the United States almost to the end of the century. With railroads came more and bigger ironworks, car foundries, the opening of more coal and iron mines, vastly increasing traffic. Steamboats began displacing sailing vessels and, just before the Civil War, iron ships began to supersede wooden craft, with further demands on the growing iron industry.

After the Civil War, railroad building in the United States proceeded feverishly, and one industry after another sprang up—steel, coke, lumber, oil, gas, brick, glass, farm implements, canning, meat packing (already well started before the war), cement, and a wide variety of smaller industries—and millions of farmers moved out onto the farms of the Mississippi valley and built homes. In the West, great irrigation works were built and millions of acres of desert land were brought into production; mines and smelters began to turn out a stream of gold, silver, and copper. Throughout this period the textile industry was also expanding, particularly in the South.

Among the more recent industries that have built up important aggregations of capital are the electrical, telephone, automobile, rubber, radio, rayon, and cigar and cigarette industries. Over the past few decades there has also been a tremendous growth of durable wealth in the form of hotels, apartment and office buildings, moving picture theaters, and modern homes.

The extraordinary growth of capital since 1879 is shown by the figures compiled by Simon Kuznets in the table below.

"Reproducible wealth outside of households" is not exactly synonymous with capital, but it approximates our concept of capital fairly well, and the figures probably represent the growth of capital with reasonable accuracy. It is noteworthy that the amount of capital did not increase much in the decade 1929–1939, the period of the great depression, but that it increased greatly in the decade which included the First World War. Apparently war slowed down capital accumulation less than the depression did.

These figures indicate an increase of capital in the United States that is probably greater than in any other country. Why is this so? The answer is that this country's abundant natural resources made this rapid increase *possible*, and the relative scarcity of labor and the high wages made it *profitable* for entrepreneurs to use much capital. Capital is made from natural resources, and our wealth of lumber, coal, oil, natural gas, and mineral deposits made it possible to produce capital cheaply and in abundance; on the other hand, the scarcity and high wages of labor provided an incentive for entrepreneurs to use capital lavishly and labor sparingly in productive operations. Hence, with an abundance of land to cultivate, an abundance of minerals from which to make farm machines, and high wages for labor, the United States set the pace for the rest of the world in

GROWTH OF REPRODUCIBLE WEALTH OUTSIDE OF HOUSEHOLDS, BY DECADES, 1879–1939.
REDUCED TO 1929 PRICES[1]

	1879	1889	1899	1909	1919	1929	1939
Total (billions of dollars)	34.3	51.9	83.4	124.5	182.7	251.7	267.8
Per capita (dollars)	707	850	1125	1385	1751	2086	2049

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[1] Simon Kuznets, *Capital Formation, 1879–1938,* University of Pennsylvania Bicentennial Conference.

the development of efficient harvesters and other farm implements; and thus it is that in practically all industrial operations we have built up the most efficient machines to be found anywhere in the world.

Capital now constitutes about one-third of the total wealth of the United States, and capital and durable consumers' goods together much more than half. Doane's estimates of the value of the various classes of goods included in these categories are as follows:

Man-Made Physical Assets (1938)[2]

Used for production (capital):	
Farm business buildings	$ 4,000,000,000
Farm equipment and livestock	9,000,000,000
Industrial-commercial buildings	34,000,000,000
Industrial equipment	20,000,000,000
Railroad buildings and tracks	13,000,000,000
Railroad equipment	5,000,000,000
Utilities buildings	13,000,000,000
Utilities equipment	7,000,000,000
Stocks of goods	11,000,000,000
Gold and silver coin and bullion	17,000,000,000
Total	$133,000,000,000
Used for comfort (consumers' goods):	
Farm dwellings	$ 5,000,000,000
Non-farm residential buildings	44,000,000,000
Public tax-exempt buildings	28,000,000,000
Motor vehicles	5,000,000,000
Ships of the United States Navy	1,000,000,000
Stocks of goods	16,000,000,000
Chattel goods	39,000,000,000
Total	$138,000,000,000
Total man-made goods remaining unconsumed	$271,000,000,000

It should be noted that "stocks of goods" included under the heading "Used for production" are capital only from the point of view of the producer, and that "stocks of goods" and "chattel goods" under the heading "Used for comfort" are presumably not all durable consumers' goods. Doane does not himself use the terms "capital" and "consumers'" goods, but the items he includes suggest that these terms are appropriate.

Capital and roundabout production

Production by the use of capital is often called roundabout. To illustrate this, Böhm-Bawerk pictured a peasant whose house is some distance from the spring where he gets drinking water. The peasant may satisfy his thirst, without any use of capital, by going to the spring whenever he is thirsty and drinking out of his hollowed hand. This is the most direct way to supply his want. Satisfaction follows immediately on exertion, but the method is inconvenient and yields satisfaction at great cost in human effort. The peasant might take a roundabout way of getting water. He might hew a pail out of a log and thus carry a day's supply of water to his cottage. This would economize his time; but before he could make the pail he must have made an ax and perhaps other tools, and before he made these he must have accumulated enough food to work at the task for several days. The peasant might, however, take an even more roundabout way of getting water. He might make an ax and with it cut down a number of trees, split and hollow them, lay them end to end, and so make a sort of aqueduct to bring the water to his door. This would take more time immediately, but in the long run it would doubtless save a great deal of time. It might well be called "capitalist production," although modern industry is of course much more roundabout and much more efficient than this.

The distinction between capital and consumers' goods

We have already seen that the distinction between land and capital is hard to draw precisely. It is similarly difficult, if indeed not impossible, to draw a precise line between capital and consumers' goods. The farmer's plow is clearly capital, for the farmer does not enjoy riding on it but uses it to produce the wheat from which he expects to make bread. The bread he enjoys eating, and it is a consumers' good. But what shall we say of an automobile used partly for pleasure and partly for business, or what shall we say if the owner uses it only for business but enjoys driving it? Apparently the car might be both capital and a consumers' good at the same time. Many farmers enjoy working with fine horses; perhaps they use decorated harnesses. Horses and harnesses are not only capital but evidently consumers' goods, to the extent that they are enjoyed. On the other hand, most consumers' goods are in a sense productive, and so resemble capital. Good food, comfortable and attractive clothes, homes and home furnishings, golf, movies, most books, and travel—all these are classified as consumers' goods, yet they may increase our productiveness and to that extent they fall into the category of capital.

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[2] Robert R. Doane, *The Anatomy of American Wealth,* p. 148.

Capital and durable goods

The title of this chapter, Capital and Durable Goods, suggests that durable consumers' goods have much in common with capital. It is true that they serve the purpose of satisfying wants directly, rather than increasing production, and there may be some current expense in maintaining them; yet they may continue to afford utility for a long time. Many of the early settlers of New England, for instance, built substantial and beautiful homes which have served their purpose for a century or more—some of them indeed for over two centuries—and are today worth more than when they were built. If instead of investing in such houses, the New Englanders had spent their money for transitory satisfactions, they would have created less wealth and New England would have been a poorer community. The man who invests in highly durable goods does not need to invest in the same type of thing the next year, but can devote his later savings to other things and so add gradually to his own wealth, which is also the wealth of the community. His own wealth, and that of the community, would presumably increase more rapidly if he invested more largely in capital, for wisely chosen capital produces a fund for maintenance and replacement, and interest too; however, since capital is useful only in producing other goods, investment in durable consumers' goods, to a certain extent, may be quite as productive. There should be a balance of capital and durable goods, and also of nondurable goods. Although, after all, the purpose of production is consumption, a philosopher looking at the American scene might well conclude that one of our greatest needs is not more gasoline and gin and cinema comedies, but more beautiful and substantial houses and other durable goods. Yet the American people do not seem to think so, and they are the final arbiters in such matters. There may be some cheer in the fact that the proportion of durable to non-durable goods has been increasing. In 1879, durable goods industries—those producing buildings, machinery, locomotives, freight and passenger cars, automobiles, refrigerators, and the like—contributed 31 per cent of our industrial output; in 1929 their contribution had risen to 44 per cent, and it is of course higher today.

It must not be assumed that all capital is durable. Some of it is, factory buildings, for instance; but the average life of much productive equipment, particularly of machines, is not very long. It is estimated that the average life of metal working equipment is not more than ten years, partly because of wear but more largely because of *obsolescence*—depreciation as the result of the development of more efficient equipment which renders the old equipment obsolete. Most capital and durable goods are subject to a fairly high rate of obsolescence because of the fast pace of technological improvement or, in the case of some durable goods, constant changes in styles. The hotels, apartments, and homes built thirty years ago are "old-fashioned" in some respects, for they lack certain shiny gadgets or superficial improvements that new buildings have, and hence have lost much of their value.

One of the important factors making for rapid obsolescence of many machines is the fact that they are made largely by engineering firms which specialize in that work. Some machines are "homemade," that is, devised by men in the plant where they are used. Some of the larger factories have staffs of technicians whose function is to develop new equipment for their own use. "Tailor-made" machines, a second class, are made by engineering firms specializing in the designing and installation of mechanical equipment, sometimes in accordance with the customer's specifications. A third class, "ready-made" equipment, is also made by machine-building firms, but in more or less standardized units—trench diggers, steam shovels, automatic looms, paving mixers, and the like.[3]

The fact that machines are built largely by specialized engineering firms doubtless tends to make industry more dynamic, more progressive and changeable in its technology, as Schlichter points out. When methods of production were determined by the persons who used them, industrial techniques had a tendency to become fixed, for men fall rather easily into a routine and dislike to change their ways of doing things. These specialized machine-building companies, however, are always striving to improve machines in order to sell more of them, for if they can make worth-while improvements on the old equipment they can virtually force industrial managers to buy the new. This is not all clear gain, of course, because the scrapping of half-worn machinery is wasteful, and some people believe that American industry sometimes discards old equipment at a real loss. In some cases industrial managers who have capitalized the older equipment add the cost of the new equipment to the capitalization, and so, after a few such shifts, their businesses are considerably overcapitalized, with capital stock outstanding for equipment that has been discarded. American businessmen have generally been readier than Europeans to scrap old equipment and install new.[4]

We have spoken of capital as being "productive"; but a word of caution is necessary here. Tools and machinery of course produce nothing themselves; they only serve to enable labor to produce more than it could without them. The labor that first produces tools and machines and works with them is more productive than labor that produces without the intervention of capital. The tools are themselves made by labor.

Capital the result of saving

Labor alone, however, cannot create new capital. There must also be *saving*, by which we mean that there must be an excess of production over consumption. As Adam Smith said, long ago: "Parsimony, and not industry, is the immediate cause of the increase of capital. Industry indeed provides the subject which parsimony accumulates. But whatever industry might acquire, if parsimony did not save and store up, the capital would never be greater." In order to secure his first club or spear point, the Neanderthal man had to *save* up enough food to enable him to work for a while on this elementary tool; and in every century since that time, additional capital has been created only by labor and saving—that is, by working and consuming less than was produced. If all laborers since the time of Caesar had worked hard and efficiently but had consumed as much as they produced, no capital would have been created, and today the world would be as poor as it was two thousand years ago.

Forced savings

Much of the saving and wealth creation of antiquity was compulsory, forced upon unwilling slaves by autocrats. The pyramids of Egypt, the temples of Babel and Baalbek, the Chinese Wall, the Colosseum, and the monuments around the Forum and along the Appian Way represented savings, excess of production over consumption on the part of people, mostly slaves or serfs, for whom saving often meant suffering, even starvation and death. The pharaoh, emperor, or king took from the people the labor power and goods needed to build these monuments, thus forcing them to economize. Tourists who marvel at the great cathedrals and castles of Europe seldom picture the oppression, hunger, and misery that were necessary to their construction; yet wealth was created that would not otherwise have existed. As homes of the nobles, these great castles were consumers' goods but were highly durable; and as fortresses they should be thought of as productive capital for those who through their use were enabled to defend themselves.

Much of the capital and durable consumers' goods produced in modern times results from compulsory saving in somewhat similar fashion, although it does not represent the same measure of suffering. The vast mills of the United States Steel Corporation, the huge Ford factory on the River Rouge, the long stretches of railroads crisscrossing the country in every direction, the cathedral-like railroad stations in some of our larger cities, the great hotels and office buildings, ships and airplanes, mines and smelters—all represent the savings of certain people. It is usually assumed that the savings are made by the wealthy capitalists who pay for these things, and in a sense this is true; but the masses of the people should be credited with a large part of these savings. Carnegie could build new plants only from profits which he made by selling steel for more than it cost him. To the extent that he made his profits by superior efficiency in manufacturing steel, he really created the means of building his plants, and the public did not need to save; but to the extent that he made his profits by exploiting his labor, the labor had to save; and to the extent that he made his profits through monopoly, the general public had to save. Behind the high tariff wall, Carnegie was able to make excessive profits for some years by charging very high prices.

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[3] Harry Jerome, *Mechanization in Industry*, pp. 51 ff.

[4] Sumner H. Slichter, *Modern Economic Society*, pp. 98, 99.

There are various other ways in which people may be forced to save. The holders of insurance policies or other contracts which call for regular periodic payments of money, although they entered willingly into these contracts, are thereafter forced to save if they wish to preserve their interest in them. All the people who incur debts subject themselves to the necessity of making forced savings, in this sense. Some corporations do not pay out all their earnings to their stockholders, but instead invest them in plant extensions and improvements—another form of forced saving.

The state, the government, may save, or may compel the masses of its people to save, in somewhat the same way that wealthy capitalists do. The magnificent government buildings in Washington, the battleships of the United States fleet, the buildings of a state university—all these represent savings of the people, who are obliged to consume less by the amount they paid in taxes to build these things. It is quite true that the people *as a whole* voluntarily voted the taxes, but all taxpayers, even those who voted against the taxes, must save enough to pay their share. In a socialist state like Russia, the government builds the factories and productive plants and forces the people to economize as much as is necessary to do this. The Russian people had to go hungry at times while the government was building some of the great industrial and power plants under the Five-Year Plan. They had to save in order that new capital could be created.

Considerable amounts of savings are sometimes "forced" by changes in the price level. Every change in the price level, up or down, transfers income from one class to another, enforcing saving upon the injured class. A rise in the price level, which means a fall in the value of money, transfers income from creditors to debtors and forces creditors to save. It also enforces savings on the part of certain other groups, particularly the salaried classes, whose incomes rise only tardily. An excellent example of forced savings of this kind is seen in practically every war.

All capital is created by savings, but this does not mean that the more people save at any given time, the more capital will be created. It appears that in times of prosperity, when people are buying consumers' goods freely, the amount of capital created is greater than in times of depression, when people are skimping on consumers' goods. This will be considered in connection with business cycles; but for the present it may be said merely that the economic system works more efficiently at some times than at others, and that when it is working well it produces a greater supply of both consumers' goods and capital. The principle that capital is created by savings is still valid. At certain times, as for instance in periods of deep depression, there may be too much saving. During such periods the "keep-the-money-circulating" principle might be good medicine, for money really does not circulate rapidly enough, and freer spending for consumers' goods would really give more employment and create more capital.

A significant change in the ideals of the people is indicated by the fact that, whereas most of the great monumental structures of ancient and medieval times were durable consumers' goods, those of today are largely productive capital. Instead of pyramids and Parthenons, we build an Empire State Building and Statler Hotels; instead of stately cathedrals, we build beautiful railroad stations and bridges. Perhaps this is indicative of a more utilitarian ideal than that of earlier times, but it also indicates a more democratic philosophy. The pyramids were of use only to the pharaohs and their families after they were dead, and the castles were enjoyed mostly by the nobles and their flunkies; but the Pennsylvania Station, the Yale University Library, and the Golden Gate Bridge are for the use of a large number of people, and mainly for productive use.

Money as capital

Is money capital? In a broad sense it is. An adequate, stable monetary system is essential to the operation of our complicated productive system, and in that sense is productive capital. If we picture a Kansas farmer trying to trade a load of wheat for a suit of clothes made in New York, we can realize how production would be hampered by the lack of a good monetary system. There were many illustrations of this in the American colonies, which were too poor to afford such a system. Yet money is a peculiar sort of capital. You cannot whittle a stick with it, or sew on a button, or drive a nail; the only way you can use it productively is to get rid of it, trade it for the things you want. Assuming an adequate monetary system, additional money adds nothing whatever to production. If the amount of money in the United States were doubled, the productiveness of the people would not be affected at all in the long run, and their total satisfactions would be no greater.

The conversion of savings into capital

In a complicated capitalist society, the fundamentals of the saving process are somewhat obscured by the use of money. The first step in capital formation is usually the saving of money. A farmer who produces two thousand dollars' worth of goods and consumes only one thousand dollars' worth of goods has a thousand dollars in *money*. If he spends it for brick and cement and builds a silo worth a thousand dollars, he adds not only to his own wealth and income (if the silo adds to his productiveness) but to the wealth of society. The silo is a profitable investment to him only if it enables him to produce more meat and milk and butter than he could have produced without it; and of course if he produces more meat and milk and butter, those products will be slightly cheaper, to the advantage of all consumers. Thus the farmer's investment in capital is a benefit to all, except to other producers of the same products, who now find competition more severe and must accept lower prices for what they produce.

If our saving farmer, instead of building a silo, had decided to lend the money to some other farmer, the effects would be much the same if the second farmer used it to build productive equipment; and a wise lender would not lend for any other purpose. The wealth of the community would be increased, farm products would be more plentiful and cheaper. If he bought bonds issued by a railroad to build new equipment, the money would be used by the railroad to purchase the needed equipment, and railroad service would be better for all. If he bought a municipal school bond, the city would spend the money for brick and cement and labor, and the result would be a new schoolhouse. In each case, saving and investment would result in the creation of capital.

If this farmer decided to spend his thousand dollars for a pleasure automobile, he himself might gain greater immediate satisfaction, but he would add nothing to the capital equipment of the community, nothing to his own productivity, if we assume that the automobile is used exclusively for pleasure. When it is worn out, the farmer will have consumed exactly as much goods as he produced—two thousand dollars' worth—and the community will have gained nothing and lost nothing.

Even a money-hoarding miser may add more to the wealth of society than a spendthrift. As already seen, the spendthrift who spends his entire income adds nothing. On the other hand, a miser who saves and hoards, in gold or silver, a thousand dollars a year—the excess of his production over his consumption—will have a hoard of $20,000 at the end of twenty years which will be a net addition to the wealth of society, for gold and silver are wealth. If he buried the money where it would never be found, he would be on a par with the spendthrift; indeed he is much like the spendthrift, very "extravagant" in his tastes. If it is argued that the spendthrift "keeps his money in circulation," the answer is that the hoarding miser leaves *goods* "in circulation" to a value equal to that of the money he fondles and buries—"consumes." If it is argued that the spendthrift gives employment to the manufacturers of automobiles and luxury goods, the answer is that the hoarder gives an equal amount of employment to miners of gold and silver. This is the simple, long-run theory of the question.

Savers are often thought of as selfish people; but it appears from the above analysis that whatever may be their motives, savers are social benefactors. Consumers' goods they might use for their own gratification, but capital is useful only to produce goods. Savers deny themselves personal satisfactions that they might enjoy, and the result is that the rest of society as well as themselves has more goods. They may secure the money that they save by grafting, overreaching, or cheating, to be sure; but spendthrifts may also get their money by such means. Perhaps a few savers save too much, skimp themselves to save money which would be invested more productively in their own health, education, and recreation than in bonds or additional equipment for their own use. Many French peasants have been accused of such parsimony, but it is not common in America.

The above implies that the mere saving of money is not sufficient to insure the creation of capital. The money must be *wisely invested.* If our saving farmer invested in a silo which proved useless, or in a dry oil well, there would be merely an increase in the number of "useless things" but not in capital. A tremendous amount of savings is wasted, and hence results in no capital formation, because it is not wisely invested. A large portion of the investments of people with small means yields no return to them and creates no useful capital—investments in gold mining stocks, oil stocks, or other speculative securities or businesses. Almost all the savings invested in the securities of new corporations is wasted, but success stories of such rich strikes as that of Senator Couzens in the Ford enterprise continue to bring in new lambs to be fleeced.

In our discussion of the farmer who saves and builds a silo, we pointed out that his saving and investment increase his own wealth and that of society, but that by increasing his productiveness they increase the supply of farm products, lower prices, and so injure other farmers as producers. This illustrates another principle that has wide application. An increase in the efficiency or productiveness of one or a few competitive producers of any good injures other producers of that good by forcing them to accept lower prices. Whenever an exceptionally efficient grocer enters a town, he adds to the troubles of the grocers already there; whenever a new and improved steamship is floated, owners of other ships find traffic harder to get and profits reduced, and some ships may indeed have to be scrapped. We may even go a step further and say that, in the short run, anyone who builds a house himself injures carpenters and plumbers; anyone who plants his own garden deprives market gardeners of a market; anyone who produces any sort of wealth, to the extent of his production, injures other producers of the same goods, in the short run.

Reversing this, we may say that the destruction of wealth benefits the producers of that kind of wealth in the short run, if other complications do not enter the picture. A hailstorm that breaks many windows benefits the glaziers, immediately; a severe cold wave increases the profits of plumbers, in the short run. It is, however, quite another thing to say that labor *in general* gains, even in the short run, by such disasters as fire, flood, hurricane, or snowstorm. A great flood, like that in Pennsylvania in the spring of 1936, may indeed raise the demand for certain kinds of labor needed in rehabilitation and rebuilding, but on the other hand it reduces employment for many other kinds of labor—people thrown out of work because the factories are flooded, those dependent for employment on the products of those factories, those engaged in selling to people ruined by the flood, those transporting and selling products of the ruined factories. An army of men and women suffer directly or indirectly from the economic dislocations arising from the disaster. And in the long run, practically all the labor in the immediate area will suffer by the destruction of wealth, the reduction of capital equipment and consequent decrease in labor's productivity, and the impoverishment of employers and the resulting reduction of funds available for the payment of wages.

"Keeping the money in circulation"

Largely because of the influence of merchants, businessmen, and advertisers, a notion prevails widely that there is something particularly meritorious about "spending" money —"keeping it in circulation." The public is constantly urged to buy consumers' goods, perhaps of only transient value, and thus "create employment" and "maintain prosperity."

The first error in the "keep-the-money-circulating" argument lies in the false assumption that money used to purchase consumers' goods circulates faster than money saved. Money saved, if not hoarded, is spent as truly as money that is spent, but for a different kind of goods. Money spent for beer or cigarettes goes to the breweries or cigarette producers after marketing costs are deducted; money saved and used to buy school bonds "circulates" to the manufacturers of brick and cement, and to laborers who spend it for various commodities. The money circulates just the same in the two cases; the only difference lies in the fact that money spent for beer or cigarettes results in present gratification, whereas money invested in school bonds results in an increase in durable wealth, which in this case is also capital if we assume that education is productive.

Neither does money spent for consumers' goods *give more employment* than money saved and invested. Just as it "circulates" to a different class of producers, so it gives employment to a different class of labor, but not *more* employment. The only difference is the fact that money saved and wisely invested increases the amount of capital, raises the productivity of labor, and in the long run raises wages. Money spent for consumers' goods does not do this. As to "giving employment," this is a phrase which should be used with great discrimination. In normal times and in the long run, no particular habit of saving or spending, of parsimony or extravagance, will create more employment than any other; in fact, no economic scheme whatever, whether of tariffs, taxation, or monetary regulation, can give more employment, in the long run, than any other scheme. This will be explained more fully in a later chapter.

The critical significance of some of the principles involved in such questions as these was well illustrated during the First World War. While the government was trying to mobilize the nation's manpower for the prosecution of the war, trying to persuade people to economize in their personal expenditures and buy bonds, businessmen were shouting for "business as usual" as the best way to win the war. "The automobile is your war weapon," declared the Motor Car Dealers' Association of one of our large cities. "The money you pay for a new car helps furnish the means for the dealer, the manufacturer, and the workman to help Uncle Sam. It all comes back to him—and he puts it right back into circulation again. The wheels are kept moving! It takes money to make them go, and the faster they go the more money is put into circulation." Only a little consideration is required to see that if the United States had "business as usual" and money circulating in the purchase of all the consumers' goods the people normally enjoy, she could not have produced many war supplies and could have rendered little help in that war.

QUESTIONS

1. Define capital. Which of the following are capital: an ax, a preacher's Bible, a needle, a watch, a book on economics, a deck of cards, a rich man's saddle horse, a farmer's work horse, a hotel, a private home, an office desk, a pair of shoes, a field of wheat, business good will, candy in a shop?
2. Distinguish capital from consumers' goods, from wealth, from economic goods, from labor, from land, from credit.
3. May a horse be capital part of the time and a consumers' good part of the time? May an actress's gowns? A fountain pen? A piano? A house? An automobile?
4. Is money capital? Assuming an adequate supply of it, what would be the advantages of adding to the supply of money? Would there be any advantage in adding to the supply of other kinds of capital?

5. Give some illustrations of "forced savings." Where would you find them, in the present inflationary situation?
6. The savings of the people of the United States amounted in 1929 to about 15 billion dollars a year. In what form, concretely, did those savings appear?
7. Do insects or animals ever use capital? Does a man ever produce without the use of capital? Socialists sometimes say that labor is the sole producer of wealth. Criticize this statement.
8. "The rates at which different people discount the future affect not only their tendency to save, as the term is ordinarily understood, but also their tendency to buy things that will be a lasting source of pleasure rather than those which give a stronger but more transient enjoyment." Illustrate this.
9. Is the purchase of an oriental rug, or a genuine antique, or a set of Mark Twain or Shakespeare somewhat like the purchase of a good bond? Explain.
10. In its long-run effect on the national wealth, what precisely is the difference between investing in productive capital and investing in highly durable consumers' goods, say houses that will last 200 years? Calculate the difference, with capital producing a 4 per cent annual return, at the end of 100 years.
11. If we ceased to employ domestic and personal servants, what would be the long-run effect on the amount of employment? On the amount of wealth?
12. Adam Smith said, "What is saved is as regularly consumed as what is annually spent, and nearly in the same time too; but it is consumed by a different set of people." Do you agree? Explain clearly.
13. "The man who dumps $100,000 in gold into the ocean gives just as much employment and does just as much to create wealth as the man who spends $100,000 for the purchase and operation of a pleasure yacht." Do you agree? Follow the results of each act carefully.
14. A man who was helping to build his house was accused of taking a job away from some workman and so of reducing wages. Is the charge valid? Does it make any difference whether there was full employment of labor or not? Does the question as to what the man does with the money he saves have anything to do with the problem?
15. The Second World War has destroyed vast amounts of capital in Europe. Will the restoration of the destroyed capital raise wages there generally? Will it raise the wages of building craftsmen above the prewar level?
16. "The mail-order house and the peddler have no interest in your community, in the schools, the churches, the highways, the town band, or the charities. Why should you patronize them?" Comment on this.
17. "I don't see that society loses anything by spending $10,000 on a Fourth of July celebration. Of course the city is out the $10,000, but all the money goes to someone who is likely to spend it, and there is no net loss." Criticize.
18. From a flour miller in Lawrence: "I do question the wisdom and 'long sight' of the Lawrence retailer who buys flour made on the outside at times because of an inducement of 5¢ or 10¢ below the price fixed by the Lawrence mills. How much Douglas County tax is paid by the outside manufacturer? Do we ask the outside manufacturer to help carry Lawrence burdens? How much of a pay roll does the outside manufacturer disburse in Lawrence?" Is this sound reasoning?
19. At his death, Jay Gould left his family a fortune of perhaps $100,000,000, largely in the form of railroad and industrial stocks. Suppose that at the present time this fortune has been largely dissipated. Suppose that $10,000,000 has been spent for perishable and unproductive luxuries—yachts and champagne, and the like. Did this give employment? If the Goulds had set fire to $10,000,000 worth of warehouses along their railroads, would it have created more or less employment? Would it have reduced the wealth of the country any more?
20. There are four farmers in a given community, each with a present income of $1000 above

a mere living. Farmer A saves his $1000 each year and puts it into better farm equipment. Farmer B hoards his $1000 in gold each year, and hides it in the yard, where it is found when he dies. Farmer C also hoards his, but he hides it where it will never be found. Farmer D spends his $1000 each year for luxuries, such as good clothes, pleasure cars, and gasoline which he uses unproductively. Follow the economic effect of each man's action and show why, from the point of view of wealth production, Farmer A stands highest, why B stands next, and why C and D are of equal merit.

21. "A certain very able businessman makes $100,000 a year in his business and spends only $2000 for living expenses. As long as he does this, it is economically the same as if he were to make a gift of his entire fortune to the public and were to work in the public service for $2000 a year, one-fiftieth of what he is worth." Explain. Argue, on the other hand, that if he spent $100,000 on his own pleasure, he would be of as little worth as a tramp, as far as the production of wealth is concerned.

Chapter 8.

Business Organization

The entrepreneur

Land, labor, and capital, without direction and management, do not produce anything. All the rich farms, waterways, water-power and mineral resources; all the energetic, specialized laborers; all the vast industrial plants with their intricate and ingenious machines and dynamos are by themselves of no economic use. They must be organized for production by the other agent of production, which in a capitalist system we call the *entrepreneur,* or businessman. The general function of the entrepreneur is to organize and manage the business, take the risks of success or failure, make the profits or suffer the losses incident to the business. As Marshall says, he "adventures," or "undertakes" its risks; he brings together the capital and the labor required for the work; he arranges or "engineers" its general plan and superintends its minor details. From another point of view, he may serve as a kind of middleman, selling the product of the land, labor, and capital to other middlemen or consumers, as in the case of the sweatshops in the clothing industry, or, less clearly, in the case of a building contractor.

The entrepreneur assumes the risks of the business. It is true that laborers take risks too, the risks of accidents and unemployment in particular, and that the owner of the capital runs a risk of losing his capital; but the entrepreneur assumes the chief risks of the business. Usually some of his own savings are invested, and he runs at least the risk of losing these. In some businesses the risk is greater than in others, but there is always some risk. Occasionally a building contractor loses his entire fortune on one contract, just as he may make a handsome profit on a single contract. A farmer feeding out a bunch of cattle may lose all he has, including his farm, in a sudden decline in livestock prices. Many livestock feeders in the Middle West lost their all in the price decline of 1921, as did some merchants who were caught with heavy stocks of goods. Gold mining was an extraordinarily precarious business when carried on by the hardy prospectors, and this was true of oil drilling in a later period; but when these businesses were taken over by big companies, they ceased to be unusually risky.

Types of business enterprises

Profit-seeking businesses may be classified into three types:

1. Individual proprietorships, of which there are about 8,000,000.
2. Partnerships, of which there are about 250,000.
3. Corporations, of which there are about 550,000.

Individual proprietorships, which include farmers and retailers, greatly outnumber all other types of business, but corporations control more wealth. Partnerships are rather rare in the business world and have been declining in recent years, whereas corporations have been increasing both in number and in relative importance for many years. The above figures are of course subject to constant change. In 1937, 351,000 business enterprises were discontinued and 400,000 new ones were established, two-fifths of them replacements in one form or another. More than 500,000 business enterprises, mostly small ones, are said to have been abandoned during World War II.

Individual proprietorships

Individual proprietors once dominated the retailing business completely, but today they do only about half of it; the rest goes to corporations, particularly chain stores. There are still several times as many individually owned stores as corporation stores, but they are generally much smaller.

The individual proprietorship is the typical form of organization in farming. Of the 6,812,350 farms in the United States in 1935, 3,210,224 were operated by full owners, 688,867 by part owners, 2,865,155 by tenants, and only 48,104 by managers; and not all the managers were operating for corporations. The individual proprietorship on the one-family farm is typical for several reasons. In the first place, the individual operator, whether owner or tenant, has in his wife and children a cheaper labor supply than any corporation or partnership could command, and he can therefore operate his land at a lower cost than is generally possible for a corporation, which must pay regular wages for all work done. In the second place, a man will probably work harder and more cheerfully for himself than for a corporation, and will take a keener interest in his own business than in that of a corporation. The fact that farmers' incomes are generally low indicates that a man will usually work for himself for a lower labor income than he would demand as an employee of a corporation. In the third place, most farm operations are not standardized and repetitive like those in a factory; they call for individual initiative and judgment which cannot be found in many laborers. In the fourth place, the farm business necessarily covers a wide area, and it is difficult to supervise a large number of scattered laborers; it would take a business genius of the highest order to manage even a hundred men engaged in ordinary farm work. A number of large farm corporations were chartered after the First World War, but almost all of those in the wheat belt failed. Perhaps with further improvement in power farming, corporations may take over much of the production of certain crops, such as wheat and some fruits; in fact, they are already crowding out many small individual fruit producers in California.

Most of the traditional economic theories regarding the general functioning of a capitalist society rest on the assumption of individual proprietorships; and to the extent that we have this form of organization, along with competition and some other essential conditions, the theories seem valid. If a man risks *his own fortune* in business, if the profits of good management are *his own*, and the losses of bad management are also *his*, he will at least try hard to manage his business well. Under such conditions, the lure of profits secures for society the best efforts of the entrepreneur. We shall presently see that the corporation form does not fit the assumptions of a capitalist society in the same way.

Partnerships

Partnerships are relatively less important than they were a century or two ago, and their total number is declining; but there are about 250,000 in the United States, mostly in investment banking, the professions, and wholesale and retail trade. They offer the advantage of greater resources than one proprietor could command, and they provide for the exercise of diverse talents within the same business. If one man is a good buyer, for instance, and another is a good salesman, the two may work together to advantage. Partnerships are common in the law and medical professions because they make it possible for either or any of the partners to get away from business for a while without serious loss to it, and they provide considerable economies in general office expenses such as office space, stenographic service, and professional library and equipment. Two or more lawyers or doctors in partnership may also command more prestige with the public than either could alone, and thus secure a higher type of business. It may be advantageous, too, for an older man who has had long experience but now does not have the vitality to carry on an active business, to enter into a partnership with a younger man with less experience and reputation but greater physical strength. Occasionally a partnership will combine one man's money with another's brains, but this is frequently unsatisfactory to the man who provides the money.

There are various disadvantages in the partnership form of proprietorship. In the first place, a partnership is an impermanent form of organization because the death of any of the partners dissolves it. In the second place, it is a decidedly risky form of business enterprise and should be entered into only by men who know each other well, because all the partners are individually liable for the acts of all the others within the scope of the business. Thus dishonesty or lack of jugdment on the part of any partner may bring heavy loss to the others. All the partners are presumed to do their work faithfully, and if one of them shirks, the others will be dissatisfied. Many a partnership has been dissolved because one or more of the members would not pull his fair share of the load. Even personal habits, such as smoking, spitting, drinking, personal slovenliness, an unpleasant disposition, or an unwholesome home life, may make a man an unsatisfactory partner. In such matters a business partnership closely resembles a marriage partnership, and a wise man will select a business partner with almost the same care that he would or *should* use in choosing a wife. Obviously, the larger a business is, the less is it adapted to the partnership form of organization. The larger the enterprise is and the more partners there are, the greater is the chance of its disruption by the death or withdrawal of one or more members. Furthermore, as O'Leary points out, the more partners there are, the more men there are to make costly mistakes for which all are liable, and the more difficult it is for each partner to know what the others are doing.[1] It is not surprising, therefore, that very large enterprises are almost always organized in another form, the corporation.

Corporations

The corporation is a "legal person or being" entirely separate from the owners of its stock; it is created by the state by means of a charter which specifies its privileges and responsibilities. It is not altogether a recent development, for it existed as early as Roman times, although in a form somewhat different from its modern counterpart. It was a fairly common form of business enterprise two hundred years ago, but its rapid development has occurred during the past century, particularly the past fifty years. At one time corporations were created by special grants of the king or Parliament in England, or of the state legislatures in the United States; but for about a century they have been created under general laws.

The money invested in a corporation is represented by various forms of securities, which may be classified as follows:

- Stocks
  - Common
    - A. Non-voting
    - B. Voting
  - Preferred
    - Non-cumulative
    - Cumulative
      - Preferred as to income
      - Preferred as to assets
- Bonds
  - Mortgage
  - Debenture

The holders of *common stock* represent, theoretically, the owning and governing body of the corporation. Through the board of directors and the officers, they theoretically determine the policies of the corporation. There may be only one class of common stockholders; but if it is desired to concentrate the voting power in a few of the stockholders, A and B stocks may be issued, the A stock carrying no voting rights but sharing equally with the B stock in dividends, if there are any.

Stocks may have any *par* value, or they may be *no par;* that is, they may have no stated par value but indicate that the owner is entitled to a certain proportion of the assets and earnings of the business. Many stocks specify $100 as par value; but in mining enterprises, particularly in small speculative or fraudulent companies, shares have been issued at a par of only a few dollars or in some cases only a few cents.

In a simple form of corporation, as for instance a small bank, no securities but common stock may be issued, but some corporations also issue *preferred stocks,* which have a prior claim on earnings but may not carry voting rights. Although preferred stocks are thus safer than common stocks of the same corporation, they do not offer the same chance for high dividends because their holders are usually paid only certain stated dividends, whereas holders of the common stock may receive any amount. Many of the railroads have large amounts of preferred stock outstanding, perhaps more than of common stock, and this of course reduces the income possibilities of the latter. Preferred stocks may be *cumulative* or *non-cumulative.* Dividends must be paid on both if earnings permit; but if dividends are not paid on the cumulative stocks in any year or series of years, the unpaid dividends *accumulate* and must be paid before anything can be paid on the common stock. Thus cumulative preferred stocks are a safer investment than ordinary or non-cumulative preferred with the same financial rating. Preferred stocks may be preferred only as to dividends or as to assets; in the latter case, in the event of the company's dissolution, their holders must be paid at par value before the common stockholders receive anything.

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[1] Paul M. O'Leary and John H. Patterson, *An Introduction to Money, Banking, and Corporations,* p. 83.

Bonds indicate a relation to the corporation far different from that of stocks. The stockholders own and theoretically control the corporation; the bondholders are merely creditors who hold the bonds as evidence of the money they lent the corporation. As long as they receive the stipulated interest on their bonds, they have no rights in the corporation; but in case of default in the interest payment they have the right, subject to some qualifications, to call for a receivership and have the corporation dissolved. If their bonds are *mortgage bonds,* they may then take over the assets of the corporation, like other mortgage holders. *Debenture bonds,* on the other hand, are simply unsecured promises to pay, based on the general credit of the borrowing corporation, and carry no such rights. There are many different kinds of bonds, with different provisions as to security and payment. From the point of view of the investor, bonds are generally safer than stocks, but from the point of view of the corporation, they always involve financial risks, like debt in any form. A corporation with nothing but common stocks outstanding, or even some preferred stocks, can usually weather a severe depression without difficulty. As long as it can pay its necessary operating expenses and taxes, it can run along without paying anything on the stocks. If there are bonds outstanding, however, the interest on these must be paid regardless of earnings, or the corporation may be thrown into a receivership and the common stock wiped out in the reorganization. One reason why so many of our railroads are often in financial trouble is that most of them have large amounts of bonds outstanding.

A corporation's capitalization may take any of a wide variety of forms. The corporation may have only common stocks, like the Ford Motor Company, or it may have some preferred stocks, or it may have not only common and preferred stocks but several issues of bonds of different grades and maturities. The Associated Gas and Electric Company, for instance, at one time had three classes of common stocks, six of preferred stocks, four of "preference" stocks, seven issues of secured bonds and notes, twenty-four classes of debentures, many of which were convertible into various kinds of preferred and common stock, four series of "investment certificates," etc. This is an extreme example, but it shows why a highly trained financial expert is necessary to understand the real status of some corporation securities.

Overcapitalization of corporations

What should be the relation of a corporation's total capitalization to the amount of money invested? As a rule, the stocks and bonds issued should represent the actual investment, but frequently they are raised far in excess of this in various ways. In the first place, stockholders are not always required to pay in the full amount of the par value of their shares. The original stockholders of the Calumet and Hecla Mining Company, for instance, are said to have paid in only $12 per share for stock with a par of $25.

Capitalization may exceed investment, in the second place, because the promoters have issued stocks to themselves or their banking promoters or friends, stocks for which little or no payment has been made. It is quite customary for promoters to keep a certain proportion of the stocks, often 20 per cent, as compensation for their services in getting the corporation established.

On the testimony of Charles Francis Adams, an expert in railway affairs, the promoters of the New York Central *injected fifty thousand dollars* of "absolute water" into the value of every mile between New York and Buffalo. In the five years between 1868 and 1872, the share capital of the Erie jumped from $17,000,000 to $78,000,000 and most of the increase was pure fiction. The company that built the Central Pacific made a profit of about sixty millions. The Louisville and Nashville added twenty millions of fiction to its stock in 1880, an example followed by the Boston and Albany two years later. About 1902 the Rock Island Company acquired the Chicago, Rock Island and Pacific "capitalized at $75,000,000 and substituted therefor its own stock to the amount of $117,000,000, together with $75,000,000 of collateral trust bonds, secured by the stock of the company acquired." Near the same time, sixty million dollars of Alton securities were issued during the short course of seven years "without one dollar of consideration."[2]

Sometimes overcapitalization results from the officers buying, as officers of the corporation, at exorbitant prices, property belonging to themselves personally, or property in which they are in some way interested. The officers and directors of the New York, New Haven and Hartford Railroad increased its capitalization from $93,000,000 in 1903 to $417,000,000 ten years later; and of this increase of $324,000,000, between $60,000,000 and $90,000,000 represented "waste and mismanagement," some of it the purchase of properties of insiders at excessive valuations. The process was somewhat similar in the building of the Union Pacific Railroad. That company was swindled out of ten or twenty million dollars by the Crédit Mobilier, a construction company formed by a ring of outsiders which built the railroad at an exorbitant price, paid in stocks of the company. This sort of thing was rather common in the history of American railroads, and various other corrupt practices helped to pump water into the capitalization of some of them. At one time it was often said that the bonded debt of many railroad companies represented about the only actual investment, the stocks representing the water added by promoters, officers, and insiders. Such exploitation is less common today.[3]

Of a different character is the increase in capitalization through "plowing back" the profits of the corporation—investing them in new plant and issuing stock against them, instead of paying them to the stockholders in dividends. In this way the capitalization may rise to figures that have no relation whatever to the original investment. Perhaps the best illustrations of this are to be found in the Standard Oil companies. The original Standard Oil Company, formed in 1870 with $1,000,000 of capital stock, grew into a number of allied corporations with total assets of several billion dollars in the course of about fifty years, largely through the reinvestment of profits; yet during that period it paid dividends of more than 2000 times the original capital stock. The Standard Oil Company of Indiana, the most spectacular money-maker in this group of concerns, was established in 1889 with a capital stock of $500,000, which had grown to $220,000,000 in 1926; of this, $184,000,000 represented stock dividends issued on profits retained by the corporation. The General Electric Company for years followed the practice of declaring stock dividends, doubtless to increase the capitalization and conceal the high rate of profits.

It is often the strong, stable, and conservative companies, like the Standard Oil companies, that adopt the policy of plowing back part of their profits instead of paying them to the stockholders as dividends. Such a policy has certain advantages. It compels the stockholders to save part of the income their capital has earned, and so tends to build up productive wealth like any other savings, and it tends to fortify the corporation itself against lean years and perhaps enables it to pay dividends more regularly. On the other hand, such enforced saving disturbs the automatic apportionment of income between saving and spending, and, according to some authorities, sometimes results in the building of more capital equipment than is really needed to produce the goods that consumers, who are receiving only part of the income due them, are able to buy. In other words, it may result in too much saving and too little spending. O'Leary suggests that it would be better for the corporation management to pay out its earnings in dividends and then, if it wishes to build more plant or equipment, obtain the money by selling the stockholders additional stock. "No corporation which cannot induce its stockholders to buy additional shares with their earnings ought to be allowed to keep such earnings, the market decision being in favor of other uses."[4] The Roosevelt administration in 1936 tried to discourage the accumulation of large corporate surpluses by imposing a heavy progressive tax on net income not distributed to stockholders. There was considerable dispute as to the wisdom of this legislation and it was later repealed.[5]

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[2] Charles and Mary Beard, *The Rise of American Civilization*, vol. ii, pp. 199–200. By permission of The Macmillan Company, publishers.

[3] For a detailed discussion of such practices, see Gustavus Myers, *History of the Great American Fortunes.*

The question may well be raised: If there is no exploitation by insiders, what difference does it make what the capitalization of a corporation is? What does it matter whether it has a million shares and pays $12 dividends on each share, or two million shares earning $6 each? Apparently it should make no difference; yet the officers of the corporation often favor a policy of ample capitalization. Public utility companies want heavy capitalization to conceal their real rate of earnings, which are subject to public regulation. Other corporations may wish to hide exceptional earnings in this manner, to avoid public hostility. If the Standard Oil Company of Indiana, for instance, were paying dividends of 4000 per cent on its original capitalization of $500,000 there would be more criticism of the "Oil Trust" than there is. Monopolies, particularly, may find it wise to inflate their capitalization in order to hide their monopoly profits. Some corporations are overcapitalized to keep the price of their stocks down within reach of ordinary investors. The more shareholders they have, the more people who are interested in seeing them do well, in protecting them from hostile legislation. Public utilities in particular often try to build up public support by getting their stock as widely scattered as possible; sometimes they put on high-pressure sales campaigns to sell as much of it as possible to their customers.[6] If the officers and insiders wish to exploit the stockholders, they can do it more easily if the stock is widely held by a large number of small stockholders.

Employee stock ownership

In order to get employees to take a proprietary interest in the business and to secure their loyalty, corporations sometimes try to induce them to buy the company's stocks and perhaps even offer them at reduced prices. A study made in 1927 indicated that more than $700,000,000 worth of stock was owned by employees. This was less than one per cent of the total value of all stocks, far too small a fraction of the total to justify the fond hope that the control of corporations is passing into the hands of the workers to build up a great system of cooperatives, particularly since most of the stocks were found to belong to a rather small proportion of the employees. Labor has generally been suspicious of employee stock purchase plans as tending to tie employees to one employer and so interfering with union organization and activities.[7]

Distribution of corporation stocks

The stocks of some of the large corporations are widely distributed. In 1937, the American Telephone and Telegraph Company listed 641,308 stock holdings, and the Pennsylvania Railroad 215,600. In 1939 the United States Steel Corporation had 167,740. In the latter year there were probably more than 18,000,000 stockholders in the United States, although estimates differ considerably.[8]

A few of the big corporations and many of the small ones are controlled to a greater or less extent by single families. The Ford family controls the Ford Motor Company absolutely, the Hartford family holds 100 per cent of the stock of The Great Atlantic and Pacific Tea Company, and William Randolph Hearst personally owned 100 per cent of the stock of the Hearst Consolidated Publications, Inc., only a few years ago; however, he has encountered some financial reverses and may have lost his control to some extent. Less complete control is held by a single family over the Gulf Oil Corporation (the Mellon family), the Koppers United Company (the Mellon family), the Sun Oil Company (the Pew family), S. H. Kress and Company, the Duke Power Company (the Duke family), E. I. du Pont de Nemours and Company, and the Aluminum Company of America (the Mellon family). In other cases, a few families own enough shares to control the organization—10 to 30 per cent of the voting stock. About 60 of the 200 largest non-financial corporations are dominated by other corporations, and about 60 others have their stocks so widely dispersed that no single interest or combination of interests can be said to control them. The latter group is rather completely dominated by its officers and directors.

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[4] Paul M. O'Leary and John H. Patterson, *An Introduction to Money, Banking, and Corporations*, p. 133.

[5] See Alfred G. Buehler, *The Undistributed Profits Tax.*

[6] For an account of such a campaign, see *New Republic*, November 29, 1933, p. 66, and December 6, 1933, p. 94.

[7] Robert F. Foerster and Else H. Dietzel, *Employee Stock Ownership.*

[8] Temporary National Economic Committee, *Monograph No. 29.*

In many of the very large corporations, no individual owns more than a small fraction of the stocks outstanding. A study made by the Federal Trade Commission in 1925 indicated that the officers and directors of 44 steam railroad companies held only 1.2 per cent of the common stock, but that the holdings of officers and directors of other corporations were somewhat higher. Berle and Means reported that, in 1929, no stockholder in the American Telephone and Telegraph Company, the Pennsylvania Railroad, or the United States Steel Corporation owned as much as 1 per cent of the stock. Using figures for December, 1937, the Temporary National Economic Committee estimated, however, that in the 200 largest non-financial corporations, the officers and directors owned 6 per cent of the common stock and over 2 per cent of the preferred stock. These percentages are higher than they would be for most corporations because these 200 corporations include some, perhaps around 20 per cent, in which stock ownership is rather highly centralized. The over-all picture is one of wide diffusion of stock ownership in most corporations on the one hand, and narrow concentration of managerial power on the other.

This wide dispersion raises the question: Who are the owners of the stocks, what classes of people? Berle and Means found that in 1929 nearly 75 per cent of the corporate dividends went to 600,000 persons having incomes of $5000 or more, nearly half went to those in this group who had incomes above $25,000, and less than 25 per cent went to several million individuals with incomes under $5000. There has been some tendency for stock ownership to shift from the rich to the middle classes, but most of the stocks are still owned by the well-to-do and the rich. On the basis of 1937 figures, the Temporary National Economic Committee estimated that 10,000 persons (0.008 of 1 per cent of the population) own 25 per cent, and 75,000 persons (0.06 of 1 per cent of the population) own fully half of "all corporate stock held by individuals in this country."

Diffusion of stock ownership and centralization of control

We may summarize the broad social effects of this dispersion of stock ownership and concentration of control as follows:

1. The owner has ceased to be an active manager of his property, as he was in a simpler economy, and has become a mere passive agent with no management functions, no control, and no responsibility.

2. Certain spiritual values that went with management and control are being lost. There was some spiritual value for the individual merchant or manufacturer in managing his own property, in seeing his business grow, and in knowing that he was building an enterprise that was a community asset. Berle and Means elaborate this idea beautifully: "The owner of non-liquid property is, in a sense, married to it. It contributes certain factors to his life, and enters into the fixed perspective of his landscape. If, for example, it be a small business, a farm, or a little mill, he lives with it, works at it, builds his life at least partly around it with an agent or some human mechanism devised to run it in his absence."[9] This spiritual

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[9] A. A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*, p. 284.

value has been lost to the stockholder.

3. The individual's wealth depends more and more on forces entirely outside himself, and less and less on his own efforts. Thus powerful forces are at work to undermine the sense of individual responsibility which is fundamental to a capitalist society.

4. The value of the individual's wealth fluctuates constantly and is subject to constant appraisal in the stock market; this causes nervous wear and tear and interest in speculation, and often affects the expenditure of the individual's income and the enjoyment of that income.

5. Individual wealth has become extremely liquid through the operation of organized stock markets, with the result that the individual is able to shift into other forms of wealth at any time. Since the ordinary stockholder does this with little intelligence he is likely to lose in the process, and perhaps finally to conclude that saving is hardly worth while.[10]

Such changes seem more fundamentally important when we consider that the corporate form includes an increasing proportion of our economic life. Corporations now dominate banking, insurance, railroads, and public utilities almost completely; they control more than nine-tenths of our mining, quarrying, and manufacturing enterprises; and they are encroaching steadily on individual proprietorships in the mercantile field. On the basis of their growth in the past, Berle and Means have predicted that "we may look forward to a time when practically all economic activity will be carried on under the corporate form."[11]

Some political luminaries and even a few economists see in this growing dispersion of stocks a great democratic movement, with more and more of the people becoming capitalists, like Carnegie and Rockefeller; but it is by no means a democratic movement. It is a drift toward a new system in which ownership of property is separated from control, in which ownership continually becomes more dispersed and control continually becomes more concentrated.

The control of the corporation rests theoretically with the stockholders, who are assumed to know the business and to be able to select the directors with intelligence. In some small corporations these assumptions may be valid. In a small bank, for instance, a dozen or a score of stockholders, businessmen in the town, may know enough about the banking business and about each other to choose competent directors; the directors may choose competent officers who, with the watchful eyes of the stockholders on them, may run the bank successfully and in the interest of the shareholders. There are also some private corporations which represent the business of an individual or a family carried on in the corporate form, and in such cases the assumptions of corporation enterprise are entirely valid. The Ford Motor Company is a good illustration of this. The stockholders, Henry Ford and family, know the business and the officers. Ford and family, well, and they know whether they are conducting the business efficiently; the directors and officers, Henry Ford and family, know the business and manage it presumably in their own interest. Such a corporation operates about the same as it would if it were carried on as an individual proprietorship, and it seems designed to secure efficiency and honesty in management. Like the simple banking corporation with only a few stockholders, it fits the assumptions of a capitalist society. If corporations could be limited to a few stockholders, many of the evils of corporation management would be eliminated.

In a few of the very large corporations, so much of the stocks were once held by a few wealthy men that the corporation principle seemed sound. This was at one time true of the Standard Oil companies, and is still true to some extent. Although there are many stockholders in these companies, a few wealthy men still own substantial minority holdings. Perhaps in a measure because of this, the management of these companies has generally been better than that of many other corporations.

The assumption of stockholder control

In the giant corporations, the assumption of stockholder control is largely moonshine. Most of the stockholders in such corporations know little or nothing about the business or about the directors or officers who serve them, and can judge of the latter's efficiency and honesty only by the dividends received. The reports of the directors are often unintelligible and sometimes even misleading, but commendatory of the management, of course. In a huge corporation like the American Telephone and Telegraph Company, it is probable that not 10 per cent of the stockholders even know who the directors and officers are, and probably not 1 per cent know whether these men are really doing their jobs well.

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[10] *Ibid.*, pp. 66–68.

[11] *Ibid.*, p. 17.

Even if the small stockholders knew something about the business and the officers, they would have little to say about the management. A hundred thousand stockholders scattered throughout the country have no way of cooperating to express their wishes. Only a few of them can afford to come to the stockholders' meetings, and if they did come they would find themselves helpless before the steam roller manipulated by the officers in control. So they sign their "proxy" slips empowering the officers to cast their votes, and the officers do as they please.

At a meeting of the stockholders of the Pure Oil Company in 1932, at which the par value of the stock was reduced from $25 to $10 per share (with a paper loss in the stockholders' equity of more than 45 million dollars), 11,173 shares of stock were voted by stockholders in person, and 3,180,395 shares were voted by proxy exercised by the officers. The average percentage voted by stockholders in person at six important meetings of oil company stockholders was 0.82 of 1 per cent; in one case it was as low as 0.000203 of 1 per cent. These were very important meetings, at which the officers and directors were completely recasting the capital structure of these corporations, generally reducing the par value of the common stock, adding to surplus to give a specious appearance of prosperity and earnings, and otherwise drastically changing the capital structure. The changes were so drastic that many of the common stockholders would probably have voted unfavorably; but they had no voice in the matter. Even if they had been present, they would have understood little of the proceedings, for only a skilled accountant could see the real intent behind the changes.

If there are a few wealthy stockholders with large holdings of stock, these men may have enough interest in the business to find out how it is being carried on, and may take an active part in protecting the small stockholders. A good illustration of this is found in the story of the Rockefeller-Stewart fight in the Standard Oil Company of Indiana. Robert Stewart, the president of the company, had been involved in the Continental Oil deal by which some 12 million barrels of oil had been bought by a group of insiders and sold to the company, at a profit of $3,000,000 to the insiders and a loss of the same amount to the stockholders, a clear violation of trust. Rockefeller, who held nearly 15 per cent of the company's stock, waged a bitter fight to oust Stewart, and finally succeeded in doing so, although Stewart was retired with a pension of $50,000 a year for his distinguished services to the company! It required all of Rockefeller's power and prestige to win the fight against Stewart, and he won by a rather narrow margin of votes—and at a personal expense of $300,000, it has been reported. It must not be assumed that wealthy stockholders will always fight for the smaller stockholders, for the profit motive might lead them to join with the officers and directors in exploiting the small holders.

Exploitation of stockholders by officers

With almost unlimited power and little responsibility to the stockholders, the officers and directors often exploit them in various ways. Overcapitalization, and the purchase of property from corporate officers at inflated prices, have been mentioned. There are many other ways. First of all, the officers and directors may take unreasonably high salaries. They are happily situated because, within certain limits, they are largely free to fix their own salaries, and the puissant profit motive often leads them to fix them high. In 1933, the salaries of all corporate executives in the United States totaled about 2 billion dollars—more than all the rent paid by corporations, five times the corporate income tax, and 64.4 per cent of the total dividend payments to stockholders; the latter percentage was higher than normal because of the depression, which reduced corporate dividends much more than salaries. These figures do not include the profits made by officers through speculation in the stock of their own corporations. The average of all salaries was only $5000. In the 570 largest corporations one-third of the chief executives received less than $25,000; another third received between $25,000 and $50,000, and the highest third received above $50,000; only 1 per cent received $100,000 or more. Salaries vary with the size of corporations, and they also vary with industries. All the salaries which were above $300,000 were paid to executives in service and trade corporations; financial and textile corporations paid the lowest salaries to their top executives.[12]

Along with high salaries the corporation officers sometimes give large bonuses to themselves, or to each other. Charles Mitchell, president of the National City Bank of New York, was paid $3,500,000 in bonuses in three years, in addition to his salary of $25,000 a year. George Washington Hill, president of the American Tobacco Company, received in 1930 a salary of $168,000 and bonuses of various kinds that brought his income up to nearly $2,500,000; and his son, a very bright young man, rose to a $100,000 salary in his father's corporation in a very few years! Four vice-presidents of the company received a total of $700,000 in salaries and $1,830,000 in cash bonuses, and 16 directors received $1,646,910 in bonuses. In 1929, the officers of one of the largest holding companies in the public utility field voted to sell 480,000 shares of its stock to a group of insiders, officials, and employees at $40 a share, although the market price was $129 to $148 a share—a gratuity of between $40,000,000 and $50,000,000. The president and the chairman of the board were allotted 30,000 shares each, and thirteen vice-presidents received an average of more than 11,000 shares each. Ten per cent of the price was to be paid in cash, the rest in installments covering a period of seven and a half years. When the market crashed in the fall of 1929, the price of this stock dropped below $40, whereupon a meeting of the stockholders was called, the entire transaction was canceled, and the insiders were given back their money with interest at 6 per cent. But this was not the whole story. Two days after the vote to permit the insiders to buy the stock at $40, they were given 55,000 shares outright. It is to be assumed that the small stockholders had little to say about this transaction.

Corporation officers may exploit stockholders and other security holders in other ways that cannot be more than mentioned because of lack of space: through the purchase of supplies and materials from other corporations in which the executives are heavily interested; through mergers and reorganizations, perhaps with consequent reduction of the legal status and value of some securities; through dilution of the capital structure by the issue of additional securities; through the use of accounting systems which do not show the real condition of the corporation, or even through the publication of false or misleading reports; through the purchase and sale of the corporation's securities on the stock exchange, taking advantage of inside information gained as company executives. For example, the officers may use such information to enable them to buy low from the present stockholders and sell high to future purchasers. The executives may not only have no interest in maintaining reasonable stability of the market price but may distribute misleading statements to create instability and further their own market manipulations. These evils, like most other evils of corporate practice, are worst in holding companies.

Just how common, in the broad field of corporation management, are such practices as these it is impossible to say. Marshall thought it was "strong proof of the marvellous growth in recent times of a spirit of honesty and uprightness in commercial matters, that the leading officers of great public companies yield as little as they do to the vast temptations to fraud which lie in their way."[13] Doubtless he is correct as to the general drift of business integrity, which in many respects is certainly higher than it was fifty or a hundred years ago. Corporation management is on a higher plane than it was in the days of the post-Civil War buccaneers; but the proportion of the total business controlled by corporations is much larger, the opportunities for corporation abuse are correspondingly greater, and highly paid lawyers show surprising ingenuity in devising new forms and processes by which executives may help themselves to generous portions of their company's earnings. Although most corporation officers take larger salaries than they should, there are many who manage their companies with reasonable fidelity to the interests of the security holders and the public. But the fact remains that there are many who pursue their own selfish interests without conscience, and a great many who are not conscientious to the point of eccentricity. All this is proved by numerous court decisions, and by reports of the Federal Trade Commission, Senate investigating committees, and various research agencies.

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[12] Twentieth Century Fund, *A Memorandum on the Problem of Big Business*, pp. 23, 24.

[13] Alfred Marshall, *Principles of Economics*, p. 303.

General reasoning leads to the same conclusion. Corporation officers have almost absolute control of other people's money. They are presumed to be actuated by the profit motive, and within wide limits they have the power of enriching themselves in many ways. It is only natural that many of them should use that power for that purpose. As Berle and Means have well said: "If we are to assume that the desire for personal profit is the prime force motivating control, we must conclude that the interests of control are different from and often radically opposed to those of ownership; that the owners most emphatically will not be served by a profit-seeking controlling group. In the operation of the corporation, the controlling group, even if they own a large block of stock, can serve their own pockets better by profiting at the expense of the company than by making profits for it."[14]

Officers often build up a line of reasoning to justify their action in treating themselves well, at any rate when profits are high. They claim that the profits are due to their own abilities and efforts, and not to those of the stockholders, who do nothing but cash their dividend checks and should therefore be content with a modest return on their investment. This reasoning may have a measure of validity; but there is no possible justification for the custom whereby some officers draw princely salaries, or perhaps even raise their salaries while their corporations' deficits are increasing and the stockholders are receiving no dividends at all. For instance, at a time when a banking holding company in Detroit was incurring growing deficits, its officers doubled their own salaries; and during the Great Depression the officers of several New York insurance companies did likewise, although their companies were in such straits that they could not live up to some of the terms in their policies. To be strictly logical, officials should work for nothing when the balance sheets indicate that they are doing their work badly.

In the relative treatment accorded high officers and subordinates we see in clear operation the Biblical (and capitalist) principle, "Unto him that hath shall be given." In times of prosperity, the salaries of the top officials have tended to rise faster than the salaries of subordinates, and in times of business recession they have fallen less rapidly, and by smaller percentages. This is what we should expect when officers fix their own salaries.

There are certain provisions of statute law and common law designed to prevent the worst abuses of corporation management, where they are brought to light; but the legislatures and the courts have been slow and blundering in their response to such problems. Even if they were not, the individual security holder is almost completely without recourse, unless he is very wealthy, for a lawsuit against the officers of a great corporation is a very expensive venture, and one not likely to be crowned with success. The corporation officers have the highest-priced lawyers at their disposal, and the courts are not generally prejudiced against them.

Corporation officers not always able

The same line of reasoning that leads to the conclusion that some corporation officers and directors are not overly scrupulous leads also to the conclusion that some of them are not very able. There is no reason to assume that thousands of stockholders, scattered over forty-eight states, ignorant of the business and unacquainted with the officers and directors of the corporation, can select competent managers. They sign the proxies that are sent to them far more blindly than they cast their votes at political elections, and hope and trust that the men elected will be competent and will manage the business to their profit. If their dividend checks stop, they may indeed wonder and doubt, but that is about all they can do.

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[14] A. A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*, p. 122.

There is tangible evidence, too, that some corporation officers are not particularly able, that some of the corporate gods have feet of clay. Samuel Insull, the great corporate "genius" of the late 'twenties who drew a salary of some $500,000 a year, was proved to be nothing but a common, unscrupulous promoter less than ten years later, when his fantastic holding-company structure crashed. The great Swedish match king, Ivar Kreuger, for a while one of the world's great financial Napoleons, was eventually found to be only a very ambitious crook, with no business judgment at all; he jumped from an airplane into the English Channel to avoid prosecution. Charles Mitchell, president of the National City Bank, one of the largest banks in the world, for a time the banking wizard of New York, received a salary and bonuses amounting to more than a million and a half a year; but within a few years he was proved to be largely ignorant of the banking business and unacquainted with some of the nicer points of business ethics. Many railroad presidents have been men of only moderate ability, if we may judge by their slowness to awaken to the problems presented by automobile, truck, and bus competition, and by the generally low standards of management still found in most of the railroads.

Lincoln Steffens describes some corporations in his quotation from James B. Dill: "Yes, don't you know that all directors are dummies? Most presidents too. Chairmen of Boards, managers, and heads of departments are real enough, but the bosses of business are the bankers and financial operators; they have no office at all in the company, but they run it through—dummies." Steffens states that he himself was offered a position as president of a corporation, and that when he insisted he knew nothing about the business he was told that it was not necessary. This corporation was controlled by a bank, but most of the railroads are so controlled.[15]

Stock exchange speculation by corporation officers

Even if a corporation officer is competent, he sometimes neglects his firm's business because, with the inside information he has regarding his own concern, he can make more than his salary speculating on the stock exchange. If his company is prospering more than the public realizes, he may buy stock before a report on the earnings is published, and later, when the price of the stock has risen, sell at a profit; or if earnings have been low he may sell stock before the facts are published, and buy again at lower prices.[16]

Corporations and tax evasion

The corporation form, and various corporation devices, have been used extensively to evade personal income taxes. We have noted how many corporations "plow back" a part of their earnings instead of paying them to the stockholders. These earnings are generally not taxed as they would be if they had been paid to stockholders or earned by individual entrepreneurs. Wealthy security holders have thus been able to escape paying taxes on large sums of income which was as real as that actually received as dividends. President Franklin D. Roosevelt secured the passage of legislation, known as the Undistributed Profits Tax Law, which taxed such incomes, but powerful corporate interests were able to force its practical repeal two years later.

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[15] Lincoln Steffens, *Autobiography*, pp. 191, 233, 234.

[16] Lincoln Steffens quotes a New York banker on this point, as follows (*ibid.*, p. 867. By permission of Harcourt, Brace and Company, publishers):

" 'Have you financiers no railroad men to operate your railroads?'

" 'Yes,' he said. 'We have them. We have men trained in operation from the ground up, and some of them have been promoted clear to the top. We find that when we take a crackerjack of a division superintendent from somewhere out west, bring him here as a vice president, and raise his salary from—nothing to $25,000 and over $50,000, he—and his wife, who came here feeling rich and well paid, soon learn that no fifty thousand a year, no salary a year, is in it with what they can have on the side, in Wall Street; so they begin to get rich, prominent, and neglectful of railroading.'

"This is generally true. All the great corporations suffer somewhat from the distracting discovery of their ablest managers that, being in on the game, they can make more in Wall Street than they can in manufacturing. Some companies have dealt with the problem of keeping their managers' minds on the business by forming them into pools and letting them tell off some one of their number to do the gambling for all. Even then they all are interested in the stock market as much as in the goods market, and this speculative interest keeps the managers of industry more or less on the side of the capitalists, big and little."

The corporation has facilitated tax evasion in other ways. Wealthy men have incorporated their residences, farms, country estates, racing stables, yachts, and even themselves. Such properties were of course operated for pleasure, but their cost was entered as a deduction from taxable income. One wealthy motor magnate saved himself $128,528 in a few years by incorporating his yacht; another saved $437,000 by incorporating his residences; a rich Philadelphia woman incorporated her various homes, racing stables, and farms, paid her husband a handsome salary for managing these enterprises, and thus piled up heavy "losses" to be deducted from her taxable income. A famous movie producer formed a "personal holding company," a corporation composed of himself, his family, and his attorney. This concern performed the function of selling the producer's services to the producing company, paid him a much lower salary than he actually earned, and kept the balance, free from taxation. This man, as an individual, thus paid an income tax on only a small income; the rest of it accumulated in his personal holding company. Most such practices were once legal, and J. P. Morgan defended them on the ground that men were justified in using any legal means of reducing their taxes; but it is obvious that since such means were not available to men with moderate incomes they represented a perversion of the corporation principle. They are doubtless much less common today than they were a decade or two ago.

Corporations and monopoly

The corporation device has encouraged the development of monopoly. It has made possible much larger units than could ever have grown up under individual proprietorships or partnerships, and has therefore reduced the number of units; and it has given a small number of men far greater power than they would otherwise have had.

The centralization of economic power and monopoly has been facilitated by the use of interlocking directorates, that is, by the officers and directors of one corporation serving on the boards of directors of other corporations. Wealthy capitalists often serve as board members of a great many corporations, sometimes as many as fifty, and in this way tend to "harmonize" the management of many concerns. Bankers are commonly included on the boards of business corporations in which they are interested, and sometimes they use their influence to preserve harmony among the various concerns; this may lead to the stifling of competition.

A statement by Ferdinand Pecora in 1939 pictures this general situation clearly:

> The members of the firms of J. P. Morgan and Company and Drexel and Company held twenty directorships in fifteen great banks and trust companies, with total assets of $3,811,400,000. They held twelve directorships in ten great railroads, with total assets of $3,430,000,000. They held nineteen directorships in thirteen public utility holding or operating companies, with total assets of $6,222,000,000. They held six directorships in as many great insurance companies, with total assets of $337,000,000. They held no less than fifty-five directorships in thirty-eight industrial corporations, with total assets of $6,000,000,000. In grand total, they held 126 directorships in 89 corporations with total assets of twenty billions—incomparably the greatest reach of power in private hands in our entire history.[17]

The Associated Gas and Electric Company in 1931 controlled several hundred corporations, so many that its vice-president confessed on the stand that he could not recall in what companies he was a director or officer, or even the nature of the business done by some of them.[18] Samuel Insull was at one time a director on 80 boards. The 18 directors of the United States Steel Corporation have 92 other business connections, representing an average of five outside businesses per director; and the various partners of Kuhn, Loeb and Company hold 65 directorships in 48 corporations.[19]

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[17] Ferdinand Pecora, *Wall Street Under Oath*, pp. 36 ff. By permission of Simon and Schuster, publishers.

[18] See *New Republic*, September 4, 1935, pp. 102, 103.

The practice of interlocking directorates brings other evils than a tendency toward monopoly. "Applied to corporations which deal with each other," Louis Brandeis has said, it "tends to disloyalty and to the violation of the fundamental law that no man can serve two masters." For instance, when the United States Steel Corporation floated a bond issue of $100,000,000 through J. P. Morgan and Company, 15 of the 24 members of the board of U. S. Steel were members of the bankers' syndicate which Morgan got together to handle the issue. Since the corporation's interests and those of the bankers were not identical, these men were in a position where disloyalty to one or the other was a definite possibility. Most banks have two classes of directors—bankers, and men in outside businesses—and many business corporations have bankers on their boards. This establishes a mutuality of interest which has its advantages; but it has its dangers as well, for there is always a chance that these interlocking directors will become confused as to whose interests they are supposed to represent. In such situations the banks, with their financial dominance, have generally fared better than the corporations.

Interlocking directorships raise yet another question: How intelligently and efficiently can a man serve half a dozen or a dozen different business corporations? Brandeis expressed himself as follows on this point: "I doubt whether anybody who is himself engaged in any important business has time to be a director in more than one large corporation. If he seeks to know about the affairs of that one corporation as much as he should know, not only in the interest of the stockholders, but in the interest of the community, he will have a field for study that will certainly occupy all the time that he has."[20]

Advantages of the corporate form

With all its possibilities for evil, the corporation device has made an imposing contribution to economic development. It is in some measure responsible for the development of great industrial plants and mass production, and has perhaps made some goods cheaper for the consuming public, notwithstanding the fact that mass production reached its highest development in Ford's individually owned plants and that the corporation device has encouraged monopoly and restriction of production. At any rate, our vast railway systems, shipping lines, industrial plants, chain stores, insurance companies, and perhaps even banks could not have reached their present magnitude without corporate organization.

A well-managed corporation, furthermore, as Marshall points out, affords an opportunity for able and ambitious men to rise to positions of power even though they have little wealth and no strong business connections. If the officers really want able young men, these men may be advanced faster than they could get ahead in businesses of their own. Hereditary wealth and business connections might be more important than they now are if all businesses were run as individual proprietorships or partnerships. To the extent that the corporation enables able men to advance rapidly to positions of influence, it performs a socially useful service.

The holding company

In the *holding company,* the inadequacies and vices of the ordinary corporation are magnified, along with some additional vices that the ordinary corporation does not have. A holding company is a corporation organized not to engage directly in production but to hold the stocks of other corporations. It may get these stocks by exchanging its own stocks for them or by purchasing them with money secured by selling its own securities. Known since fifty years ago, the holding company has become widespread in recent years, particularly in the field of public utilities. This has been due to the desire for monopoly control, to the desire of bankers for new opportunities for loans and the sale of securities, and in general to "the desire [on the part of the promoters] for commercial expansion, greed, or personal ambition to become dominating factors

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[19] Temporary National Economic Committee, *Monograph No. 13,* p. 120 ff.

[20] A. T. Mason, *The Brandeis Way,* p. 49.

With $500,000 of their own money, the promoters could buy half of the voting stock, which would be sufficient to control the $8,000,000 holding company; or they might even take this stock without any cash payment, as compensation for their services in promoting the company. Let us assume that they really paid for it, selling the rest of the stock and bonds to the public. They would now have a holding company with $8,000,000 in cash assets. With these funds, let us suppose that they set up Subholding Company B, with the following capitalization:

Common stock	
B stock (voting)	$16,000,000
A stock (non-voting)	16,000,000
Preferred stock	30,000,000
Bonds	30,000,000
Total capitalization	$92,000,000

With $8,000,000—50 per cent of the voting common stock—they would now control Subholding Company B, and if they could sell the other stocks and bonds to the public, they would have cash assets of $92,000,000. With this sum they could buy a controlling interest in operating companies that were really engaged in some kind of production, to a total of at least $200,000,000; for ownership of 40 to 50 per cent of the voting stock, or even 25 per cent, usually insures control of a corporation. Thus an investment of $500,000 would give the promoters control over $200,000,000 of corporate assets.

At one time promoters went much further and created hierarchies of ten or a dozen subholding companies, one above the other. In the Associated Gas and Electric holding-company system there were twelve companies in one line of control from top to bottom of the pyramid, and in the Insull system there were seven. Such financial legerdemain would not be permitted today.

Among the serious dangers of holding-company pyramiding, as the Federal Trade Commission points out, were the opportunities afforded for "the manipulation of accounts, secrecy as to financial conditions, concealment of assets, liabilities, profits or losses, diversion of profits or losses through intercompany channels, all of which may result to the detriment of the investor or the rate-paying public and to the benefit of controlling interests."[25] There was a further danger that the promoters might build an organization so complicated that they could not understand it themselves. Hopson, of the Associated Gas and Electric Company, finally became so entangled in the intricacies of his own holding company that he unwittingly violated a criminal law and as a result was sent to the penitentiary. The corporate structure of this holding company is shown in Fig. 2, taken from the report of the Federal Trade Commission on utility corporations.

As we have seen, the highly pyramided holding company permitted one or a few individuals to control enormous amounts of capital supplied by other people. If the operating companies at the base of the pyramid earned high profits, the men in control might receive extraordinary returns on their investment, sometimes 100 per cent or more; but if the earnings of the operating companies fell to a low level, the entire structure might collapse, as some of them did after the crisis of 1929. This was the reason for the crash of the Insull public utility empire, which carried down with it not only the top holding companies but some of the operating companies as well, for in trying to save his superstructure Insull bled the operating companies in every way possible.

Individuals or groups with small investments might secure control in other ways. The holding companies often owned all the voting stocks of the operating companies; the non-voting stocks, common and preferred, and the bonds, which of course carried no voting privileges, were sold to the public. In some cases, the management of the holding company has issued what are known as "management shares" which sold for a very low price but carried full voting privileges. For instance, in 1924, H. M. Byllesby and Company insured its control of the Standard Gas and Electric Company by issuing and selling to itself nearly a million such shares at one dollar each; Henry L. Doherty and Company followed a similar procedure in 1929.

The holding company could tighten its control of an operating company by providing it

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[25] *Ibid.*, p. 357.

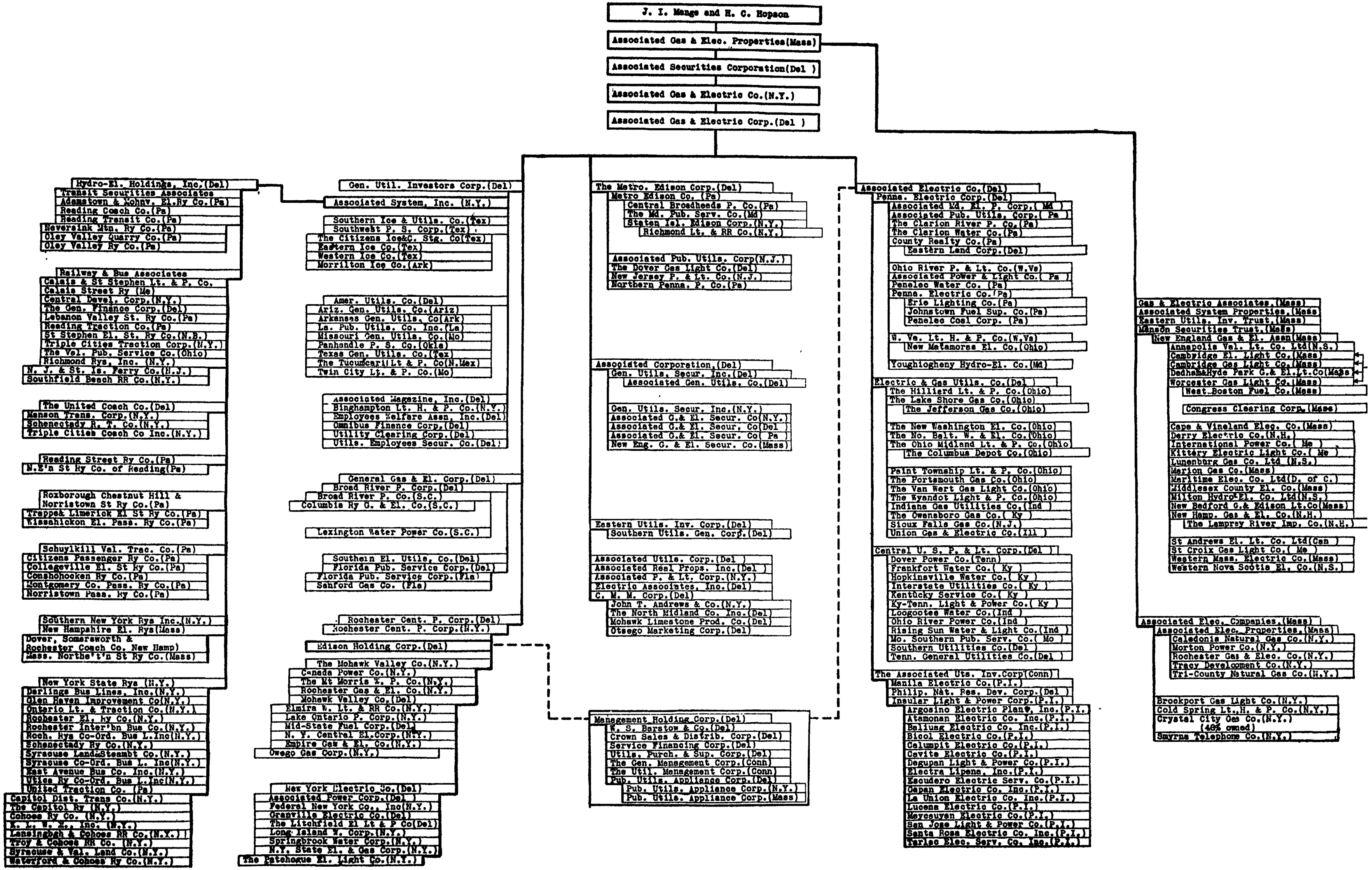
J. I. Mange and H. C. Hopson
Associated Gas & Elec. Properties(Mass)
Associated Securities Corporation(Del)
Associated Gas & Electric Co.(N.Y.)
Associated Gas & Electric Corp.(Del)
Hydro-El. Holdings, Inc.(Del)
Transit Securities Associates
Adamstown & Mohnv. El.Ry Co.(Pa)
Reading Coach Co.(Pa)
Reading Transit Co.(Pa)
Neversink Mtn. Ry Co.(Pa)
Oley Valley Quarry Co.(Pa)
Oley Valley Ry Co.(Pa)
Railway & Bus Associates
Calais & St Stephen Lt. & P. Co.
Calais Street Ry (Me)
Central Devel. Corp.(N.Y.)
The Gen. Finance Corp.(Del)
Lebanon Valley St. Ry Co.(Pa)
Reading Traction Co.(Pa)
St Stephen El. St. Ry Co.(N.B.)
Triple Cities Traction Corp.(N.Y.)
The Val. Pub. Service Co.(Ohio)
Richmond Rys. Inc. (N.Y.)
N. J. & St. Is. Ferry Co.(N.J.)
Southfield Beach RR Co.(N.Y.)
The United Coach Co.(Del)
Manson Trans. Corp.(N.Y.)
Schenectady R. T. Co.(N.Y.)
Triple Cities Coach Co Inc.(N.Y.)
Reading Street Ry Co.(Pa)
N.E'n St Ry Co. of Reading(Pa)
Roxborough Chestnut Hill &
Norristown St Ry Co.(Pa)
Trappe& Limerick El St Ry Co.(Pa)
Wissahickon El. Pass. Ry Co.(Pa)
Schuylkill Val. Trac. Co.(Pa)
Citizens Passenger Ry Co.(Pa)
Collegeville El. St Ry Co.(Pa)
Conshohocken Ry Co.(Pa)
Montgomery Co. Pass. Ry Co.(Pa)
Norristown Pass. Ry Co.(Pa)
Southern New York Rys Inc.(N.Y.)
New Hampshire El. Rys(Mass)
Dover, Somersworth &
Rochester Coach Co. New Hamp)
Mass. Northe't'n St Ry Co.(Mass)
New York State Rys (N.Y.)
Darlings Bus Lines, Inc.(N.Y.)
Glen Haven Improvement Co(N.Y.)
Ontario Lt. & Traction Co.(N.Y.)
Rochester El. Ry Co.(N.Y.)
Rochester Inter'bn Bus Co.(N.Y.)
Roch. Rys Co-Ord. Bus L.Inc(N.Y.)
Schenectady Ry Co.(N.Y.)
Syracuse Land&Steambt Co.(N.Y.)
Syracuse Co-Ord. Bus L. Inc(N.Y.)
East Avenue Bus Co. Inc.(N.Y.)
Utica Ry Co-Ord. Bus L.Inc(N.Y.)
United Traction Co. (Pa)
Capitol Dist. Trans Co.(N.Y.)
The Capitol Ry (N.Y.)
Cohoes Ry Co. (N.Y.)
K. L. W. X., Inc. (N.Y.)
Lansingbgh & Cohoes RR Co.(N.Y.)
Troy & Cohoes RR Co. (N.Y.)
Syracuse & Val. Land Co.(N.Y.)
Waterford & Cohoes Ry Co.(N.Y.)
Gen. Util. Investors Corp.(Del)
Associated System, Inc. (N.Y.)
Southern Ice & Utils. Co.(Tex)
Southwest P. S. Corp.(Tex)
The Citizens Ice&C. Stg. Co(Tex)
Eastern Ice Co.(Tex)
Western Ice Co.(Tex)
Morrilton Ice Co.(Ark)
Amer. Utils. Co.(Del)
Ariz. Gen. Utils. Co.(Ariz)
Arkansas Gen. Utils. Co(Ark)
La. Pub. Utils. Co. Inc.(La)
Missouri Gen. Utils. Co.(Mo)
Panhandle P. S. Co.(Okla)
Texas Gen. Utils. Co.(Tex)
The Tucumcari Lt & P. Co(N.Mex)
Twin City Lt. & P. Co.(Mo)
Associated Magazine, Inc.(Del)
Binghampton Lt. H. & P. Co.(N.Y.)
Employees Welfare Assn. Inc.(Del)
Omnibus Finance Corp.(Del)
Utility Clearing Corp.(Del)
Utils. Employees Secur. Co.(Del)
General Gas & El. Corp.(Del)
Broad River P. Corp.(Del)
Broad River P. Co.(S.C.)
Columbia Ry G. & El. Co.(S.C.)
Lexington Water Power Co.(S.C.)
Southern El. Utils. Co.(Del)
Florida Pub. Service Corp.(Del)
Florida Pub. Service Corp.(Fla)
Sanford Gas Co. (Fla)
Rochester Cent. P. Corp.(Del)
Rochester Cent. P. Corp.(N.Y.)
Edison Holding Corp.(Del)
The Mohawk Valley Co.(N.Y.)
Canada Power Co.(N.Y.)
The Mt Morris W. P. Co.(N.Y.)
Rochester Gas & El. Co.(N.Y.)
Mohawk Valley Co.(Del)
Elmira W. Lt. & RR Co.(N.Y.)
Lake Ontario P. Corp.(N.Y.)
Mid-State Fuel Corp.(Del)
N. Y. Central El.Corp.(N.Y.)
Empire Gas & El. Co.(N.Y.)
Owego Gas Corp.(N.Y.)
New York Electric Co.(Del)
Associated Power Corp.(Del)
Federal New York Co., Inc(N.Y.)
Granville Electric Co.(Del)
The Litchfield El Lt & P Co(Del)
Long Island W. Corp.(N.Y.)
Springbrook Water Corp.(N.Y.)
N.Y. State El. & Gas Corp.(N.Y.)
The Patchogue El. Light Co.(N.Y.)
The Metro. Edison Corp.(Del)
Metro Edison Co. (Pa)
Central Broadheads P. Co.(Pa)
The Md. Pub. Serv. Co.(Md)
Staten Isl. Edison Corp.(N.Y.)
Richmond Lt. & RR Co.(N.Y.)
Associated Pub. Utils. Corp(N.J.)
The Dover Gas Light Co.(Del)
New Jersey P. & Lt. Co.(N.J.)
Northern Penna. P. Co.(Pa)
Associated Corporation,(Del)
Gen. Utils. Secur. Inc.(Del)
Associated Gen. Utils. Co.(Del)
Gen. Utils. Secur. Inc.(N.Y.)
Associated G.& El. Secur. Co(N.Y.)
Associated G.& El. Secur. Co(Del)
Associated G.& El. Secur. Co(Pa)
New Eng. G. & El. Secur. Co.(Mass)
Eastern Utils. Inv. Corp.(Del)
Southern Utils. Gen. Corp.(Del)
Associated Utils. Corp.(Del)
Associated Real Props. Inc.(Del)
Associated P. & Lt. Corp.(N.Y.)
Electric Associates, Inc.(Del)
C. M. M. Corp.(Del)
John T. Andrews & Co.(N.Y.)
The North Midland Co. Inc.(Del)
Mohawk Limestone Prod. Co.(Del)
Otsego Marketing Corp.(Del)
Management Holding Corp.(Del)
W. S. Barstow & Co.(Del)
Crown Sales & Distrib. Corp.(Del)
Service Financing Corp.(Del)
Utils. Purch. & Sup. Corp.(Del)
The Gen. Management Corp.(Conn)
The Util. Management Corp.(Conn)
Pub. Utils. Appliance Corp.(Del)
Pub. Utils. Appliance Corp.(N.Y.)
Pub. Utils. Appliance Corp.(Mass)
Associated Electric Co.(Del)
Penna. Electric Corp.(Del)
Associated Md. El. P. Corp.(Md)
Associated Pub. Utils. Corp.(Pa)
The Clarion River P. Co.(Pa)
The Clarion Water Co.(Pa)
County Realty Co.(Pa)
Eastern Land Corp.(Del)
Ohio River P. & Lt. Co.(W.Va)
Associated Power & Light Co.(Pa)
Penelec Water Co. (Pa)
Penna. Electric Co.(Pa)
Erie Lighting Co.(Pa)
Johnstown Fuel Sup. Co.(Pa)
Penelec Coal Corp. (Pa)
W. Va. Lt. H. & P. Co.(W.Va)
New Matamoras El. Co.(Ohio)
Youghiogheny Hydro-El. Co.(Md)
Electric & Gas Utils. Co.(Del)
The Hilliard Lt. & P. Co.(Ohio)
The Lake Shore Gas Co.(Ohio)
The Jefferson Gas Co.(Ohio)
The New Washington El. Co.(Ohio)
The No. Balt. W. & El. Co.(Ohio)
The Ohio Midland Lt. & P. Co.(Ohio)
The Columbus Depot Co.(Ohio)
Paint Township Lt. & P. Co.(Ohio)
The Portsmouth Gas Co.(Ohio)
The Van Wert Gas Light Co.(Ohio)
The Wyandot Light & P. Co.(Ohio)
Indiana Gas Utilities Co.(Ind)
The Owensboro Gas Co.(Ky)
Sioux Falls Gas Co.(N.J.)
Union Gas & Electric Co.(Ill)
Central U. S. P. & Lt. Corp.(Del)
Dover Power Co.(Tenn)
Frankfort Water Co.(Ky)
Hopkinsville Water Co.(Ky)
Interstate Utilities Co.(Ky)
Kentucky Service Co.(Ky)
Ky-Tenn. Light & Power Co.(Ky)
Loogootee Water Co.(Ind)
Ohio River Power Co.(Ind)
Rising Sun Water & Light Co.(Ind)
Mo. Southern Pub. Serv. Co.(Mo)
Southern Utilities Co.(Del)
Tenn. General Utilities Co.(Del)
The Associated Uts. Inv.Corp(Conn)
Manila Electric Co.(P.I.)
Philip. Nat. Res. Dev. Corp.(Del)
Insular Light & Power Corp.(P.I.)
Argosino Electric Plant, Inc.(P.I.)
Atamonan Electric Co. Inc.(P.I.)
Baliuag Electric Co. Inc.(P.I.)
Bicol Electric Co.(P.I.)
Calumpit Electric Co.(P.I.)
Cavite Electric Co.(P.I.)
Dagupan Light & Power Co.(P.I.)
Electra Lipena, Inc.(P.I.)
Escudero Electric Serv. Co.(P.I.)
Gapan Electric Co. Inc.(P.I.)
La Union Electric Co. Inc.(P.I.)
Lucena Electric Co.(P.I.)
Meycauyan Electric Co.(P.I.)
San Jose Light & Power Co.(P.I.)
Santa Rosa Electric Co. Inc.(P.I.)
Tarlac Elec. Serv. Co. Inc.(P.I.)
Gas & Electric Associates.(Mass)
Associated System Properties.(Mass)
Eastern Utils. Inv. Trust.(Mass)
Manson Securities Trust.(Mass)
New England Gas & El. Assn(Mass)
Annapolis Val. Lt. Co. Ltd(N.S.)
Cambridge El. Light Co.(Mass)
Cambridge Gas Light Co.(Mass)
Dedham&Hyde Park G.& El.Lt.Co(Mass)
Worcester Gas Light Co.(Mass)
West Boston Fuel Co.(Mass)
Congress Clearing Corp.(Mass)
Cape & Vineland Elec. Co.(Mass)
Derry Electric Co.(N.H.)
International Power Co.(Me)
Kittery Electric Light Co.(Me)
Lunenburg Gas Co. Ltd (N.S.)
Marion Gas Co.(Mass)
Maritime Elec. Co. Ltd(D. of C.)
Middlesex County El. Co.(Mass)
Milton Hydro-El. Co. Ltd(N.S.)
New Bedford G.& Edison Lt.Co(Mass)
New Hamp. Gas & El. Co.(N.H.)
The Lamprey River Imp. Co.(N.H.)
St Andrews El. Lt. Co. Ltd(Can)
St Croix Gas Light Co.(Me)
Western Mass. Electric Co.(Mass)
Western Nova Scotia El. Co.(N.S.)
Associated Elec. Companies.(Mass)
Associated Elec. Properties.(Mass)
Caledonia Natural Gas Co.(N.Y.)
Morton Power Co.(N.Y.)
Rochester Gas & Elec. Co.(N.Y.)
Tracy Development Co.(N.Y.)
Tri-County Natural Gas Co.(N.Y.)
Brockport Gas Light Co.(N.Y.)
Cold Spring Lt.,H. & P. Co.(N.Y.)
Crystal City Gas Co.(N.Y.)
(48% owned)
Smyrna Telephone Co.(N.Y.)

FIG. 2. Associated Gas & Electric System, Corporate Chart, March 31, 1932.

with a large reserve of authorized but unissued voting stock. If outside interests secured enough stock to threaten its control, the holding company could then issue and sell to itself enough of this stock to retain control. When operating companies were regarded as so many cows to be milked, bitter financial battles for their control frequently ensued.

A complete list of holding-company vices, as seen in the public utility field, would include other practices: overcapitalization, reorganization to evade the law or existing contracts, payment of unearned dividends to give a false appearance of financial soundness, and propaganda—at the public's expense—in the press, the schools, and elsewhere. Some of these practices, such as overcapitalization, were very common, but others were doubtless rarely resorted to. The Federal Trade Commission's examination of 91 public utility operating companies, whose combined capital assets totaled nearly $3,307,000,000, disclosed write-ups and other improperly capitalized items amounting to no less than $599, 237, 206. Additional write-ups on approximately 25 other operating companies brought the aggregate up to $864,231,623.

David Cushman Coyle has summarized the operations of many holding companies with some perspicacity:

> The holding company game is a good deal more complicated, and not even the people who shuffle the cards understand all of it. During the big argument last spring [1934], a good many people got the impression that holding companies were primarily devices for sticking the consumer. There may have been some of that, but mostly they were devices for sticking the investor. The main idea was to get so many layers of companies one on top of another that nobody could understand what was going on. Then the operators bought and sold stocks among the different layers, with some of the money falling off the table every time they pushed it around. The game was to carry off the waste basket at the end of the day. Sometimes the Right People got away with the money, and sometimes hijackers got it, but the investor never has been able to find out where it went.[26]

It must be said that holding companies are behaving better than they once did, and some of the reprehensible practices described above are no longer permitted by the government.

General conclusion as to corporations

The broad, general question raised by the increasing dominance of American industry by corporations has perhaps been stated best by Berle and Means:

> The concentration of economic power separate from ownership has, in fact, created economic empires, and has delivered these empires into the hands of a new form of absolutism, relegating "owners" to the position of those who supply the means whereby the new princes may exercise their power. The recognition that industry has come to be dominated by these economic autocrats must bring with it a realization of the hollowness of the familiar statement that economic enterprise in America is a matter of individual enterprise. To the dozen or so men in control, there is room for such initiative. For the tens and even hundreds of thousands of workers and of owners in a single enterprise, individual initiative no longer exists. Their activity is group activity on a scale so large that the individual, except he be in a position of control, has dropped into relative insignificance. At the same time the problems of control have become problems in economic government.[27]

Government policy with respect to corporations

There are some who see no serious corporation problem at all, who believe that with all its faults the corporation has worked as well as most human institutions can be expected to work. Marshall apparently was of this mind, but he wrote at a time when the corporation had not assumed its present importance. This view is untenable now. Irresponsible management and control cannot be accepted as a satisfactory form of business enterprise, for it resembles too closely the dictatorships of Fascist countries applied in the economic sphere. Although the investing public may continue to furnish the steady flow of funds needed by the corporation system, it will demand better protection than it has had in the past. Even if standards of corporation ethics were to rise considerably and corporation officers were to consider more seriously the interests of their employees and of the public, this economic dictatorship should not be tolerated. The government must assume some control, and is doing so.

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[26] David Cushman Coyle, *Brass Tacks*, pp. 23–24.

[27] A. A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*, pp. 124–125. By permission of The Macmillan Company, publishers.

How far the government should go is a debatable question. A law requiring federal incorporation of all corporations doing interstate business would represent a fair start. At the present time most corporations incorporate under state laws, which are generally very lax in their requirements. In order to secure the revenues incident to the establishment and operation of corporations, some of the states, as for instance New Jersey, Delaware, and Maryland, have adopted laws which are very lenient regarding capitalization, publicity of accounts, and various corporation practices; and corporations formed under these lax laws operate in other states. Most of the patent-medicine companies are incorporated in a few eastern states whose incorporation laws are easy on that kind of business. The states with the lowest standards "get the business" and perhaps receive considerable revenues as a result. The glass panels in the doors of one office building in Wilmington, Delaware, have been made very large to accommodate the great number of companies which use the same office as their legal address —modest little collective "homes by the sea," where American freedom of enterprise flourishes at its highest and best.[28] Federal incorporation would stop this "competition in laxness of regulatory provisions."

The Federal Securities Act

The Federal Securities Act of 1933 was the public response to some startling revelations of shady practices on the part of corporations, banks, and investment houses during the preceding years. In the drastic stock market shakeout of 1929 to 1932, investors lost hundreds of millions in securities, and resulting investigations brought out clearly the need for closer regulation of the stock market and of the issue and sale of corporation securities.[29]

The Securities Act was designed to force investment banks "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce." Before issuing securities the investment banks or investment houses must file with the Securities and Exchange Commission a statement covering such information as an investor should have; and any false information or the omission of material facts which might mislead the investor rendered the issuing banks, the corporations for whom the securities were being sold, and even the accountants liable to the investor for any losses he suffered. These provisions were so drastic that banks and investment houses insisted that they could not safely engage in the financing of new enterprises. Few new corporate security issues were being issued at that time, but it is difficult to say whether this was due to the harsh provisions of the law, to a "strike" of the investment agencies designed to prove the law unworkable, or to the paralytic depression of the times; perhaps it was due to all these in some measure. At any rate, the provisions of the law were somewhat moderated in 1934, but the stock exchanges, the bankers, and the investment houses are still fighting it.

The Securities Act contains various other provisions designed to raise the ethical level of trading on the stock exchange: it forbids the organization of pools to force the prices of securities up or down; forbids fictitious transactions engaged in for the purpose of making it appear that certain stocks are being bought and sold actively; forbids short sales (sales made by those who do not own the stocks being sold) by corporation officers in the stocks of their own corporations; and restricts the purchase and sale, by officers and directors, of securities of their own corporations. The Securities and Exchange Commission (the SEC) has the function of applying and enforcing these and other provisions of the act.

It is not yet clear how effective the Securities Act is likely to be. It has not generally been administered with unreasonable harshness, yet Wall Street complains that it is ruining the investment market. The New York Stock Exchange and many New York investment agencies certainly needed to clean house, but whether it is possible to provide effective regulation without interfering with legitimate investment remains to be seen.

Holding companies, which as we have seen have provided some of our worst financial scandals, should be regulated with particular care. President Franklin D. Roosevelt tried to secure their abolition in the field of public utilities; but after a long and bitter fight he was able only to secure passage of the Wheeler-Rayburn Act in 1935, which brought them under the jurisdiction of the Securities and Exchange Commission by requiring them to furnish the Commission full and complete information about various aspects of their business. Many of their bad practices are now proscribed, although the Wheeler-Rayburn Act allows the SEC considerable latitude in regulating these companies. This is true, for instance, in its administration of the "death sentence" clause of the act, the clause prohibiting the pyramiding of holding companies more than "two-deep." A holding company may still control a number of operating companies, but the piling up of additional holding companies above the parent holding company is no longer permitted. The SEC was given the task of leveling the pyramids, but with some discretion as to final arrangements lest there be too much disruption of business. If business should gain control of the SEC and put in men who were hostile to the purposes of the law, holding companies would soon again be enjoying the anarchy of the good old days; but if the Commission remains true to the aims of the Wheeler-Rayburn Act, the main evils of the holding-company structure will perhaps be eliminated.

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[28] Russel A. Dixon, *Economic Institutions and Cultural Change*, p. 353.

[29] On the banking irregularities of the time, see Ferdinand Pecora, *Wall Street Under Oath*.

The system of interlocking directorates, with its intricate intercorporation connections, its endless ramifications of power and influence, is definitely inconsistent with the assumptions of competitive capitalism, and should be subjected to a major operation of some sort. Louis Brandeis argues convincingly for their complete abolition, and it is possible that this would not only eliminate some unethical corporation practices but improve the efficiency of corporation management. Men who are directors in as many as fifty corporations are probably not worth much to any of them, as far as management is concerned; and the elimination of interlocking directorates would tend to induce wealthy stockholders to concentrate their investments in one business and learn something about it. In that way it would tend to reunite ownership and control, a reasonable policy for the kind of business world economists are accustomed to theorize about.[80]

Public ownership of stocks

All the measures suggested here would be inadequate to make the corporate organization work well. Perhaps the government should go further and secure a block of stock in each of the large corporations. It would not need to buy the stocks, but could take them from the estates of wealthy decedents under the inheritance tax, instead of requiring the payment of the tax in cash. As a stockholder, the government could have a representative at the meetings, could observe the procedure, and in case of questionable practices could take appropriate action to protect the stockholders. With its powers and resources it could of course do far more for their protection than they could individually. The government might go so far as to require that it should have at least one director on the board of all large corporations to guard the interests of the other stockholders and of the public. This proposal will perhaps seem very radical and it would involve serious difficulties of administration; but it does not weight too heavily the public interest in corporation business. Nothing less can afford the people the protection they should have.

The drift toward absentee ownership

The corporation in its various forms represents one aspect of a fundamental economic trend which we must view with some misgiving, the drift toward *absentee ownership*. At one time the farmer owned his land; the merchant owned his store; the manufacturer usually owned his modest factory; the dweller on farm and in town owned his home; the carpenter or cabinetmaker, the shoemaker, the candlestick maker, owned their own tools. In its separation of ownership and control and of ownership and use, the corporation represents only one aspect of the general trend. Each decade shows a smaller proportion of farmers who own their own farms, of merchants who own their stores, of manufacturers who own their factories, of people who own their own homes; and the carpenters, shoemakers, and other craftsmen work in factories with machines in which they have no proprietary interest. The institution of private property is being altered, weakened, or abandoned at so many points that we may well wonder what is the final end toward which we are drifting.

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[80] See Louis D. Brandeis, *Other People's Money*, chap. 3.

QUESTIONS

1. Which of the following are entrepreneurs: a carpenter, a contractor, the chancellor of your university, a professor, a corporation president, the manager of athletics? In what cases would the entrepreneur also be a laborer, capitalist, or landowner?
2. What are the advantages and disadvantages of the partnership? Why do the disadvantages grow as the number of partners increases?
3. In what respects is the business partnership like marriage?
4. What is a corporation charter? Who grants the charter? Why are so many corporations chartered in Delaware?
5. Describe the various securities used by corporations. Who selects the president? Who chooses the directors? Are the employees "rugged individualists"? Where would you go to find "rugged individualists" in the modern economy?
6. "The corporation is inconsistent with the assumptions of a capitalist system." Explain. Why have we maintained a fairly efficient economic system in spite of the spread of the corporation form of business enterprise?
7. Does it make any difference to the public what the total capitalization of an ordinary business corporation is? Does it make any difference in the case of a public utility? Is there any reason to believe that some public utilities are overcapitalized? Why might they be?
8. Carver saw a great movement toward industrial democracy in the growth of corporations and in the diffusion of stock ownership among large numbers of people. Is this a democratic movement?
9. If you were manager of a corporation, what various forms of action would your self-interest lead you to? If you did only moderately well for the stockholders, would they throw you out and put in a better man?
10. A man holds stock in fifty different corporations. How does he manage to keep informed as to the management of so many firms?
11. Explain clearly the pyramiding process by which promoters of holding companies gain control of great wealth with a small investment. Describe some other practices used to achieve the same end.
12. What kind of economy would we have if there were no corporations? How would we have fared in the Second World War? If corporations are inconsistent with the assumptions of a capitalist system and yet are necessary to efficient production, what shall we do with them?

Chapter 9.

The Size of Business Units

Definition: ways of measuring "size"

The "size" of a business unit may refer either to the physical size of the *individual plant* or to the size of the *unit of ownership or financial control.* There has been a general increase in size from both these points of view, but the trend toward large-scale plants came earlier, for the most part before 1900, and their consolidation into vast financial units came largely after the plants had reached almost their present size. The factors responsible for the development of huge plants are in some respects different from those that brought large-scale ownership or control; hence the two lines of development must be considered separately, although it is not possible to make a clear-cut separation at all points. Many of the available sources of information on the subject are vague as to what they mean by the "size" of business units.

There are various ways of measuring business concerns—on the basis of the number of laborers employed, or the value added by manufacturing, or the value of the product, or the amount of assets, or various other standards—and the ranking of an individual concern will differ according to the standard selected. Thus the Standard Oil Company of New Jersey, with assets of nearly 2 billion dollars, employs only 50,000 men; the General Motors Corporation, with about 1.5 billion in assets, has more than four times as many men; and the United States Rubber Company, whose assets total less than one-tenth those of Standard Oil of New Jersey, employs almost as many men.

THE SIZE OF INDIVIDUAL PLANTS

The forces that have brought large-scale plants

Economic historians differ somewhat in their interpretation of the forces that are responsible for the appearance of large-scale plants. One school, following Adam Smith's famous dictum, "The division of labour is limited by the extent of the market," emphasizes the significance of the widening of the market which resulted from improved transportation and the settlement of new lands in the Americas and elsewhere. Large plants can develop only where there is a wide market for their products. There could have been no very large factories in colonial times because there were almost no roads, water transportation was slow and inefficient, and therefore only as much goods could be produced as could be sold in a narrow market. A cotton mill as large as the present plant at Pawtucket, Rhode Island, would have flooded the Boston market of 1750 with the output of a few days' operation, and the steel plant at Gary, Indiana, could in a few hours have made a year's supply of steel for the Boston of that time. Large plants require wide markets.

Another school of historians, while admitting the significance of this factor, finds the important cause for the development of large-scale production in technological factors, in improvements in machines, engines, and power, and in advances in the sciences, particularly chemistry, physics, and metallurgy.

We do not need to choose between these

two views, for both are essentially correct. Large-scale production would have been impossible without both wide markets and improved technology, and each of these helps to promote the other. For instance, the improvements in machines, engines, and power made possible the building of railways and the widening of the market; and the railways, in turn, by bringing raw materials and coal together from long distances away, made possible further improvements in machines. Widening markets and technological progress have gone hand in hand.[1]

Transportation and communication have unquestionably been very important in the development of large-scale production. The railroads with their extraordinary capacity for hauling freight long distances at small cost, the steamships that carry goods at an even smaller cost from port to port throughout the world, the canals and fine roads, and the millions of trucks that speed from city to city day and night—all these have vastly broadened the market for goods of all kinds and have provided the conditions necessary for large-scale production. In all these means of transportation there has been steady improvement too. Freight trains and locomotives and steamships have increased steadily in capacity and in speed and promptness of service; the steel made in Pittsburgh and Bethlehem, the lumber sawed in Washington, the oil flowing from Texas wells, find markets in every quarter of the globe. Improvements in transportation facilitate not only the distribution of goods but its sale as well. Where the drummer once rode from town to town on a slow train and spent endless hours in hotels or railroad stations waiting for the next train, he now drives his own car and covers several times as much territory; if the selling is done by mail, letters travel quickly by train or airplane. People move about faster on business or other errands and are much more likely to reach their destination on schedule. Passenger trains are speedier and more dependable, busses are faster than the trains of fifty years ago, and an increasing number of travelers use planes.

Communication is also important. Without the telegraph, telephone, cable, radio, air mail, and fast mail ship, wide markets would be far more difficult to maintain. People today can scarcely realize how difficult it was a century ago to establish any business connections between places only a few hundred miles apart. At the time of the Civil War and even later, mail transportation was so slow and uncertain that it sometimes took weeks for letters to travel from the eastern seaboard to the Missouri River towns.

With improved transportation, advertising media have grown up which help to widen the market. Some magazines and newspapers are read in every part of the United States, and they offer an excellent medium for advertising on a national scale. The radio is devoted mostly to this purpose, and by the skillful use of comedians and jazz bands has built up nation-wide markets for certain brands of toothpaste, cigarettes, laxatives, canned milk, and automobiles. What improved transportation has done for the physical movement of goods, improved communication has done for their sales.

Historical development of large-scale industry

Large-scale production developed first in manufacturing, particularly in the textile industry, and in transportation; it spread to mining, lumbering, and fishing, and finally to marketing, entertainment, and many miscellaneous industries. It appeared first in England and had progressed far by 1850; in the United States it developed largely after 1860, and somewhat later but more rapidly in Germany; but in France it never secured the hold that it has in other leading industrial countries. It has made greater advances in the United States than in any other country, although Russia, before 1941, was working feverishly on a program of large-scale production in agriculture as well as in industry.

It is often assumed that the trend toward large-scale production in the United States has been steady and continuous down to the present time. On the contrary, it took place largely, although not entirely, between 1860 and 1900. Since 1900, and even in the decade between 1909 and 1919, there has been some increase in the proportion of large plants, but such plants lost ground between 1919 and 1929. The general picture in recent years has been somewhat distorted by the rapid growth of certain industries in which plants are very large—the automobile, rubber tire, sugar refining, and electrical in particular.

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[1] See the article by Myron W. Watkins in *Encyclopaedia of the Social Sciences*, vol. ix, p. 170.

The forces responsible for the factory system and large-scale plants are well illustrated by the history of the shoe industry in the United States. In early pioneer days, shoes were commonly made by one member of the family. The labor cost of such shoes was of course high because the makers worked at the task only occasionally and therefore with little skill. The cost of the tools was high in terms of output, for they were used only a few days in the year. The shoes were crudely made, some of them without lefts and rights, and all without finish or style. A great saving in the cost of labor and tools and an improvement in the quality of the shoes came with the appearance of the specialized shoemaker, who went from home to home or set up shop in the town. The advantages of this division of labor were evident, and they increased when labor was further subdivided—when such operations as measuring, fitting, cutting the leather, and selling the shoes were separated from the actual shoemaking process and given to specialists, under the domestic or "putting-out" system. Although this growing specialization brought greater efficiency, the domestic system still involved waste and inefficiency in the distribution and collection of materials, in imperfect coordination of the various tasks, and in poor standardization of output; furthermore, the workers in their homes or shops had to depend on manpower. The invention of the sewing machine made the factory system inevitable, for such an expensive machine could not be entrusted to the irregular and ill-coordinated operation of scattered home or shop workers, and it demanded power, which could be best supplied in a factory. Railroads made possible a wide market for the greater output of the factory, and the final impetus to large-scale production was given by quantity orders for standardized shoes for the Army during the Civil War.

Advantages of large plants

In industries which require large plants, such a plant has a number of advantages. There is economy in the construction and operation of the plant, including the machinery. A large plant costs less than a small one in proportion to the amount of space provided, and it can be heated, cleaned, and guarded more economically. Certain types of production call for large-scale equipment that is both increasingly expensive and increasingly productive. In the iron and steel industry, for instance, the automatic strip mill has reduced the amount of labor to about 3 per cent of that formerly needed in hand mills; but the six stands used in a typical mill weigh about 5,000,000 pounds and are very expensive. The average sum required to build a modern steelworks of efficient size is approximately $100,000,000. The small plant in this industry is nearly obsolete. In the mining of certain ores, the change to open cut or surface mining, which is done with giant electric shovels, has similarly thrown the balance in favor of large producers, at the same time reducing costs very considerably. In the manufacture of bricks, large plants can produce at a labor cost 40 per cent less than the small plants; and in cement manufacturing, the increase in kiln capacity in recent years has resulted in important economies in the use of labor, capital, and fuel, but has meant larger and more expensive plants. Many other instances similar to this could be cited.

A large plant may have an important advantage in the fact that its expensive machines have a lower obsolescence cost, per unit of output. It can sometimes afford machines that would not be worth their cost in a small plant, highly productive but expensive machines which, to pay their way, must be used a great deal, that is, must produce a large output. A large plant which can keep an expensive machine going all the time and turn out 100,000 units of output will have an obsolescence cost on that machine, per unit of product, only half that of a small plant which keeps the machine busy only half the time and turns out only 50,000 units of output. In the foundry business, for example, X-ray or gamma-ray apparatus, which is very expensive and demands carefully trained operators, can test castings so much better than any other device that some buyers demand that their castings shall be so tested; but only a large plant can turn out enough of them to justify the investment.[3]

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[3] Temporary National Economic Committee, *Monograph No.* 22, pp. 197 ff.

The large plant can employ not only specialized machines to greater advantage but various kinds of specialized workers, such as engineers, physicists, chemists, statisticians, and accountants. One expert hired by Ford was credited with having effected savings of $36,000,000 within a few years.

Power costs are considerably lower for large plants that produce their own power, for the larger the generator, the lower the cost per horsepower to install, operate, and care for it. Fuel costs per unit of power produced are also lower. This particular advantage is less important than it once was, because an increasing proportion of industrial plants do not generate their own power but buy it from central stations; but they may pay a lower rate, and by using more power per man-hour they get a generally larger output per unit of labor and of capital investment.

Improvements in transportation and communication have increased the relative advantages of large plants by increasing the efficiency of management. The various devices for communication and for the speedy transfer of messages within the plant enable the manager to maintain close touch with all his men. Moreover, electric and gasoline trucks are of course speedier and more efficient than the horses once used in carting goods from one part of the plant to another. Doubtless too, the development of more efficient accounting and statistical methods has enabled the manager of a big plant to understand some of his problems better.

The superior efficiency of large plants in the utilization of by-products is often mentioned. This advantage was less important in Marshall's day, and hence he did not weight it heavily; but in recent years there has been rapid progress in the use of by-products. Large plants are of course equipped to do this more efficiently than small ones. At one time many butchers and small packing houses utilized little but the meat and hides; today the large packing houses convert the carcasses into meat, leather, soap, brushes, glue, isinglass, tennis strings, drum snares, buttons, artificial teeth, fertilizers, and a wide variety of pharmaceuticals. By-products, including the hide, bring 12.7 per cent of the return from a steer and 18.6 per cent of that from a sheep. Except for the hides, these products would be largely wasted by a small plant. The big packers say that they sell the dressed carcass of a steer for several dollars less than they pay for the live animal, their entire income being derived from the sale of by-products. It is this factor, in part, which has almost eliminated the town butcher and the small slaughterhouses from the economic picture.

In the oil industry likewise, the larger refineries have developed the manufacture of many by-products which the small "skimming plants" once wasted. Some of the larger sawmills now use sawdust as fuel or convert it into insulating material. There are scores of different insulating materials on the market today, many of them made as by-products of some other industry. A small plant might well be able to utilize some of its most valuable by-products, but only a plant with a large output could produce them in sufficient volume to justify their manufacture and sale. Obviously the utilization of by-products is of greater importance in some industries than in others—in meat packing and oil refining, for instance, than in cotton textile manufacturing.

A large concern, whether a large plant or a large financial unit, has great advantages in buying raw materials and in selling its finished product. It buys in large quantities at regular intervals, perhaps taking all the output of certain producers, and so is able to secure low prices. This is true partly because of its strong bargaining power, and partly because the expense to the seller is less per unit in large than in small quantities. The sale and delivery of a hundred carloads of flour, to be delivered over a period of a year, costs the seller little more time and expense than the sale and delivery of a single carload. Furthermore, up to a certain point there may be increasing returns in the advertising and sale of some commodities—that is, the more that are sold, the more that can be sold—for, assuming that the product is satisfactory, each sale tends to advertise it and to make other sales possible. There is, of course, a limit to this expansion, a limit set by the appeal of rival brands and of rival products.

The management of large plants

Although executives of large concerns usually take generous salaries, the administrative expenses per unit of output are generally lower in such concerns than in small ones, and the manager may be an abler man. If he is, and if the business is not too large, he has some advantages in administration. Marshall discusses these advantages in too rosy terms, doubtless because he had in mind not a vast industrial empire, such as the General Motors Corporation, but what we would now call a moderately large concern. Nevertheless, his words are worth quoting: "The head of a large business can reserve all his strength for the broadest and most fundamental problems of his trade: he must indeed assure himself that his managers, clerks, and foremen are the right men for their work, and are doing their work well; but beyond this he need not trouble himself much about details. He can keep his mind fresh and clear for thinking out the most difficult and vital problems of his business. . . ."[3]

Advantages of small plants

Not all the advantages are with the big plant. The owner of a small plant has advantages of his own. He can give his personal attention to many of the details of his business and can know his business well, not from reports of subordinates but from his own observation. He has important advantages in dealing with labor. He can know his employees personally, and thus be able to preserve more friendly relations than the manager of a big plant. He is less likely to be troubled with labor unions, and his wage scale is usually lower. In the meat-packing industry in certain northern states, for instance, the small companies paid an average of 59 cents an hour in 1937, whereas the "Big Four" paid 71 cents. Such wage differentials are possible partly because many small plants are located in smaller towns and cities where living costs are generally lower; and the workers in such plants, even at the lower wages, may fare as well as those in big plants in large cities.[4]

The operator of a small plant also has an advantage in the fact that he can avoid much of the expense of bookkeeping, of checks and balances, of the "red tape" and bureaucracy inevitable in a large business. It is to his advantage too that business secrecy has diminished, and that many trade and technical journals are available to bring him information about the broader aspects of his own industry which was once accessible only to those who could hire their own agents to gather such information. And of course the small plant has an advantage in the fact that its area is small and there is less expense in moving men and materials from one part of the plant to another.

Farming generally a small business

Certain types of business tend to remain small, in spite of the general trend toward increased plant size. The most important of these is agriculture, for the average farm is still small; in 1935 it contained only 154.8 acres. In diversified agriculture the average farm is growing larger, but the unit is still small, for reasons which have already been discussed.[5] In specialized farming, such as the growing of fruit, berries, sugar beets, and to a lesser extent wheat and cotton, forces are at work that are tending to drive out the old one-family farm owned by the operator, and substitute for it a much larger unit, the "factory in the field," corporation- or banker-controlled, perhaps employing poor, landless, homeless, hopeless, migratory workers—Mexicans, Negroes, Italians, and Americans. On the fruit ranches of the Pacific coast, on the berry farms of New Jersey and Arkansas, on the beet sugar ranches of Colorado, Utah, and Michigan, the independent farmer is retreating before the same forces that drove the handicraftsman out of most industries. Even though corporation-controlled farming has not made much progress in wheat and cotton growing, the average farm is steadily increasing in size, and the one-family farm seems on the way to being engulfed in the tide of new capitalist techniques.[6]

Retailing still a small-plant business

Retailing is carried on mainly in small plants, even where the financial organization is large-scale, as in the chain stores. There were

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[3] Alfred Marshall, *Principles of Economics*, p. 284.

[4] Temporary National Economic Committee, *Monograph No. 14.*

[5] See p. 89.

[6] See Carey McWilliams, *Ill Fares the Land.*

1,654,000 retailing establishments in the country in 1935—one retail outlet for every 80 persons. Of these stores, 97 per cent made sales totaling less than $100,000 annually, and 60 per cent made sales of less than $10,000. Nearly a million of them rang up less than $33 a day. There are a few very large department stores, such as Wanamaker's, Macy's, and Marshall Field's, but the proportion of business they do has declined. The big supermarkets have grown rapidly in the past few years, but even the largest of these is small compared with our large industrial plants.

The typical retail store is small for two reasons. In the first place, retail goods are generally sold to customers in person, which means that they can be sold only to a relatively small number, those within a radius which permits visits to the store. Where selling is done without this personal contact, by mail for instance, we have such immense plants as those of Sears, Roebuck, and Montgomery, Ward; but even these great concerns have thought it wise to establish smaller local stores in many scattered towns and cities. In the second place, the principle of decreasing cost apparently does not operate in retailing after the plant has reached a modest size. Paul Nystrom was one of the first to point out that the large retailers do not necessarily have lower costs than their smaller rivals, and that they therefore do not crowd these smaller retailers out. A very large grocery store does of course enjoy some economies, but in some of its operations it has higher costs than a moderate-sized store, as for instance in the greater distances that its customers and employees have to walk to find the things they want. A moderate-sized grocery store is large enough to carry an adequate selection of foods; and additional floor space involves increasing expense in some ways.

The big department stores and mail-order houses represent large plants, but in their internal organization they are merely a combination of moderate-sized retail agencies operating under one roof. With regard to the sales of any particular product, they are not large-scale business at all.

Small plants in service industries

Another field in which the small plant persists is in non-professional personal services: restaurants, barber shops, drinking places, automobile garages and repair shops, beauty parlors, trucking and taxicab businesses, laundries, jewelry repairing, plumbing shops, and a wide variety of other similar enterprises. Before the war, the average annual receipts of such businesses were small, only $10,700 for restaurants and $5600 for garages. Like retail stores, they remain small because they must be easily accessible to their customers and there are no important economies in large plants.

The optimum size of plants

Much has been written about the *optimum size* of a plant, the size at which economies are at their maximum. Theoretically there is some such optimum size, but practically it is difficult to determine. Moreover, the concept is obviously not very definite, for, as we have seen, plants differing greatly in size often operate competitively for many years and none crowds out the others. Variations in size in every industry are so great that the concept of optimum size is nebulous.

The Size of Business Units: Financial Control

From our discussion of plant size, we now turn to the consideration of the size of the *financial units* of control. Historically, large-scale plants developed first, and combinations of those plants came afterward. As we have seen, the movement toward large-scale plants was largely completed as early as 1900. When little could be gained by further expansion of individual plants, enterprising promoters began gathering them into big financial combinations through outright purchase, merger, or holding-company control. To some extent this movement developed from the search for real economies in manufacturing and marketing; to some extent it marked the path toward monopoly control; and to some extent it was the expression of the promoters' hunger for the profits made possible by such combinations or for the glory of being great "captains of industry."

Forms of combination

Combination may be *horizontal, vertical,* or *complex.* A horizontal combination is *a combination of business units engaged in the same* *kind of business*—for instance, flour mills, meat-packing plants, or cement plants. A vertical combination is *a combination of business units operating in the various stages of the process of making, and perhaps selling, a commodity.* The Standard Oil companies, producing crude oil, refining it, transporting it through pipe lines, and selling it through their own service stations, are vertical combinations. This form of combination is often called *integration.* A complex combination *may be both horizontal and vertical, or partly horizontal and partly vertical; and, as Bye says, it may "ramify into various fields which are more or less loosely associated with its main activities,"* combining business units which produce *different* products. In this latter aspect it is sometimes called *complementary* combination. The General Motors Corporation is a complex combination, as are many of our other giant concerns.

Horizontal combination

Good examples of horizontal combination may be seen in General Mills, Inc., now in control of 25 milling companies; the Ward Baking Corporation, with 21 bakeries; and the National Dairy Products Corporation, with 331 dairy companies.

The advantages of horizontal combination are to a limited extent the same as those enjoyed by large plants, but they are for the most part quite different in character. Like the big plants, and in yet greater measure, the horizontal combination may have advantages in buying and selling. One investigation revealed that the price of yeast varied from 14 to 25 cents per pound, according to the amount purchased. A certain flashlight battery was sold at 2.5 cents to toy manufacturers who bought in large quantities, whereas wholesale jobbers paid 5 cents and retailers 6.5 cents. Chain stores and the big mail-order houses are often able to wring large price concessions from manufacturers. Sears, Roebuck used to buy tires made by Goodyear so cheaply that they could sell them for 40 per cent less than the regular retailers asked. This advantage in buying works to some extent to the injury of the concerns from which the goods are bought, although the public may benefit through lower retail prices.

A horizontal combination may similarly enjoy economies in purchasing raw materials, because it can buy in large quantities. It can save something on marketing costs, particularly in advertising, for it requires fewer salesmen to sell its products than separate plants need, it can afford better delivery service at a lower cost, and it can advertise more effectively. The great cigarette combinations can put on a more effective advertising campaign than the individual manufacturers could, operating separately, although many perfectly rational people will not see great social gains in this. A horizontal combination may have certain plants specialize in the manufacture of certain products, may save on cross-freight charges by shipping to each local market from the nearest producing plant; it may secure greater continuity of operation by a carefully planned schedule of distributing orders to its various plants; it may save by installing uniform accounting systems and informing all its plants concerning the best technological practices used in the most efficient of them; it may save by standardizing products and reducing the number of varieties produced; and it can obtain capital much more cheaply than an individual plant can. If the value of the product is high relative to freight charges, and if fairly small plants can produce with maximum efficiency, the combination may lower costs by decentralizing production, that is, by acquiring or building plants in small communities where wages and living costs are lower than in the cities. And finally, since it is a big concern, it can make better use of by-products than an individual plant, carry on research on a more extended scale, and utilize patents and fight infringements better—or perhaps rob others of their patents.[7]

These are *possible* advantages *to the combination,* and not necessarily to the public. Although some horizontal combinations have unquestionably reduced costs and have passed the lower costs on to the public in lower-priced goods, the general record of horizontal combinations is far from imposing. Many of them have manifested no evidence of efficiency. According to Fetter, who testified before the Temporary National Economic Committee:

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[7] Temporary National Economic Committee, *Monograph No. 27,* pp. 165 ff.

> It is apparent that "the economy of large production" . . . is essentially a phenomenon of the single-unit plant rather than of plural-unit plants. It is a matter of internal arrangements and economies within a single plant. It is technical or technological, not financial or commercial.
>
> It will be observed that [horizontal] combination . . . gives unity to the ownership, but not to the productive processes of the subsidiary plants. The physical plants and equipment remain largely under decentralized management; they still produce singly, while the officers of the controlling corporation are concerned almost wholly with financial and general organization and commercial matters. It is well to remember this when considering the claims of increased productive efficiency that are made for size attained by combination.[8]

Myron W. Watkins, one of the leading authorities on combinations, is quite as critical of the combination movement, particularly horizontal combination:

> It is hard to escape the conclusion that the major "financial" advantage sought and secured by corporate consolidation was the opportunity afforded, through the dispersion of ownership interests and through the erection of intricate, pyramided, labyrinthine, corporate structures, for the manipulation of corporate funds, corporate policies, and corporate accounts by "insiders," or irresponsible "outsiders," to their own enrichment and without regard to the interests of the enterprise, the workers, the stockholders, or, least of all, the consumers. It is difficult to escape that conclusion because the record of what has transpired in the actual course of events is so replete with evidence of utilization of the power thus conferred for the purposes indicated.
>
> The strategic advantages afforded by consolidation were primarily related to the control of the markets either for raw materials or for products, or for both.[9]

The financial history of horizontal combinations does not justify the common notion that they are even generally very profitable. Earnings have seldom been equal to expectations, and have frequently been less than the aggregate earnings of the units before consolidation. Among the more important reasons for this are the following:

1. Many combinations have been overcapitalized, in some cases with fixed bond obligations which later caused embarrassment.

2. In some instances old plants were scrapped and new ones built, at heavy expense, with resulting investment greater than the income justified.

3. The promotion expense has often been very high, sometimes paid in stock, with resulting overcapitalization.

4. In many instances the management has been unequal to the larger tasks imposed by combination. The larger any business consolidation grows, the more difficult the problems of administration become, the more red tape is necessary, and the more chance there is for friction with the employees and for the appearance of the heavy inertia that characterizes most big business.

Altogether, granted that there are some possible economies, little can be said for horizontal combinations; in fact, there are many reasons for believing that they constitute a grave obstacle to the successful operation of a capitalist system. The corporation vice of divorce of ownership from control is here even more vicious, for the stockholder-owners in a combination are twice-removed from control of their property, and there are more opportunities for exploiting them, opportunities which are often used, as the records of such combinations abundantly prove.

One of the worst aspects of this form of combination is the fact that it has largely robbed the smaller industrial communities of their economic independence, has made them mere business dependencies of the great financial centers. The writer lives in a town that has several industries, all of them owned by residents of the town who have a personal interest in it and take pride in its development. These owners are managing their own businesses; the stocks are not quoted on the exchanges, and there is no speculation in them, no rigging of the market, no manipulation by insiders—none of the evils that arise in highly organized corporate capitalism. In many towns the situation is not so happy, towns in which most or all of the industries are controlled from New York or Chicago and run by hired managers who have little interest in the towns and little or nothing invested in the industries themselves. The centralization of economic control in New

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[8] Temporary National Economic Committee, *Monograph No. 13*, p. 107.

[9] *Ibid.*, pp. 98, 99.

York City, partly the result of horizontal combination, is probably an important cause of the decline of capitalism.

Vertical combination

The second type of combination, known as *vertical combination*, or *integration*, includes units engaged in the various productive processes from the raw material to the finished product. The United States Steel Corporation represents this form, as well as horizontal combination. The Ford Motor Company in its many plants performs all the industrial operations necessary to produce the finished automobile, from the iron and lead mines to assembling plants. Most of the great oil companies own their own oil deposits, wells, pipe lines, refineries, and some of their service stations, thus performing every service from pumping the oil from the ground to filling the gasoline tanks at the service station. The lumber business shows the same tendency. At one time the production of lumber was often divided among a number of concerns, one owning the standing timber, another cutting the trees and hauling the logs to the mill, which was owned by unrelated interests; and the retailing was done by various independent lumber yards. Today many of the large lumber companies own their own timber stands—in some cases enough to last many years—do their own logging, saw the logs into lumber in their own mills, and sell it through their own lumber yards. This is complete integration.

Integration has been general in some industries in this country and in Europe as well, particularly in Germany, but it has by no means been universal. Where sources of raw materials are widely scattered, as in the flour-milling, meat-packing, woolen, cotton, tobacco, silk, and flax industries, manufacturers have not tried to control raw materials; and as a rule they have not developed their own retail outlets. Manufacturers who process farm products have not reached out to integrate the farms as part of their organization because they can secure their raw materials more cheaply from the farmers than they could produce them if they took over the farms. The farmers sell much of their produce at prices which probably do not cover even costs of production, including a reasonable income for their labor.

Integration has brought more substantial advantages than has horizontal combination. Perhaps the most important advantage is the fact that through integration the producers at each stage of the process are assured of adequate raw materials and markets. In the oil business, for instance, the crude oil producers in an integrated combination are assured a market for their product; the refiners have an assured supply of crude and, through their service stations, a dependable access to consumer markets; and the integrated pipe lines provide transportation facilities for both crude and in some cases for gasoline.

If there were keen competition everywhere along the line, it might make little difference whether all the operations in the oil industry were carried on independently or were under the control of a single company. Under conditions of sharp competition, with a large number of units at every stage of production, oil producers, refiners, pipe lines, and service stations would be able to buy their supplies and sell their products at any time, at prices set in the market, and there would be little chance of effecting important economies through integration. Monopoly anywhere along the line, however, might put the operators in a tight place. Thus monopoly in production might shut off the supply of crude oil and halt the operations of the refiners; or monopoly in refining might squeeze the producers through reductions in the price of crude, as it has often done. Even without monopoly, conditions might change in such a way as to bring distress to individual operating companies. In times of serious overproduction of gasoline, as in 1923, refiners who had no service station outlets found themselves in a precarious position because of their inability to sell their products, and as a result they tried to establish their own chains of service stations. As a matter of necessity, the large oil companies are almost completely integrated, and the future is not very bright for the smaller independents who are not so integrated.

A similar situation exists in some other industries, and for somewhat the same reasons. The United States Steel Corporation is in a more secure position because it owns its own ore reserves. Lumber mills have found it wise, if not absolutely necessary, to acquire their own timber reserves. In some instances lumber companies built expensive sawmills, on the far too complacent assumption that they would be able to buy logs from the owners of nearby standing timber. These companies thus being at a disadvantage, the loggers and timber owners exacted a monopoly price for their saw logs; some of them even built their own mills, leaving those already in existence without raw material, or by threatening to do this were able to buy the existing mills at bankruptcy prices. The advantage was not always with the timber owners, to be sure, for business depressions caused them severe distress because of the uncertainty of finding a market for their logs. For these reasons, mill owners have found it wise to buy stands of timber, and many timber owners have bought or built sawmills. Thus integration has developed in the lumber industry, to the general advantage of its members, and probably of the public as well.

A second advantage of integration is inherent in the technical conditions in certain industries. There is real economy in combining blast furnaces and steel mills, so that the metal produced can be processed without being reheated; in combining pulp and paper mills, so that the pulp can be made into paper without the expense of drying. Such economies as these are similar to the economies of large-scale operation in a single plant. Possibly also, when the operators are integrated vertically, each taking his raw material from the preceding operator and passing his output on to the next in line, inventories, or stocks of materials, need not be as large as would be necessary if the operators at each step were buying and selling in the open market and were never sure how much they would need or could dispose of. It would be incorrect, however, to think of the operators in an integrated combination as fitting perfectly into a nice plan whereby each produces exactly the right amount of output for the operator at the next stage and each one's plant works steadily and at full capacity. There are always some misfits, some operators whose productive capacities are too great for the general scheme and who therefore may have to run at less than full capacity or sell part of their output in the market, and other operators who do not produce enough, with the result that their output may have to be supplemented by purchases in the market. There are maladjustments in integrated industries, as elsewhere; and some students of the problem believe that such combinations tend to be static, inflexible, incapable of meeting changing conditions, just as, indeed, most big business is.[10]

It is sometimes argued that integration brings economy by saving the profit margins which otherwise would go to the operators at each step of the productive process; but there is reason to doubt whether much can be saved in this way. In a competitive situation, each operator along the line would ordinarily buy his materials and sell his output at prices covering cost of production, including rent, interest, wages, and the salaries of the managerial staff; and all these expenses the integrated company would likewise have to meet. It might be argued that if there were monopoly at some point—for instance, in the steel industry, if the ore were owned by a monoply which exacted monopoly profits from the steel manufacturers—integration would make it possible to save paying these monopoly profits by bringing the monopoly into the combination. However, if there were such a monopoly, it would be in a position to charge the promoters of the combination a high price for its business, a price high enough, theoretically, to capitalize its former monopoly profits. It is doubtful whether the saving of profits is an important advantage of integration.

Complex combination

It should not be assumed that horizontal and vertical combinations are usually clearly distinguishable, that combination takes either one form or the other, for the two kinds are often found together in an almost infinite variety of forms. A combination may include, horizontally, a number of plants manufacturing certain products, it may be fully integrated, and in addition it may own several plants that make a great variety of products unrelated to its main business. The United States Steel Corporation, referred to earlier as an example of integration, also represents horizontal combination, for it controls a number of steel mills and fabricating works, and a considerable number of other businesses. This giant concern has been well described in a monograph of the Temporary National Economic Committee: "In addition to its facilities for producing pig iron, steel ingots, and all forms of finished and semifinished steel products, the corporation owned and operated through some 150 subsidiaries, in 1937, nearly 2000 oil and natural gas wells, 89 iron ore mines, 79 coal mines, some 40 limestone, dolomite, cement rock, and clay quarries, a number of gypsum and fluorspar mines, 2 zinc mines, a manganese ore mine in Brazil, over 5000 coking ovens, several water supply systems with reservoirs, filtration plants, and pumping stations, over 100 ocean, lake, and river steamers, 500 barges and tugs, railroads, fire brick plants, and mills producing 12,000,000 barrels of cement."[11]

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[10] Temporary National Economic Committee, *Monograph No. 27*, chap. 8.

Similarly, the big mail-order houses combine a mail-order business with chains of retail stores and a number of factories. General Motors is a horizontal combination of automobile plants, is fully integrated, and owns plants for the manufacture of refrigerators and a great many other products. In some cases plants have been combined which produce the most diverse and apparently unrelated products: toilet preparations and sporting goods; fertilizers and non-ferrous metal alloys; insecticides and machine-shop products; compressed and liquefied gases and machinery; soap, flavoring extracts, and paints; linseed oil and foundry supplies; fertilizers and carpets and rugs.

Combinations of this type offer certain advantages, particularly in marketing. Thus the big meat packers, who already have cold-storage warehouses for meats and the facilities for selling meats to the retailers, can sell poultry, eggs, cheese, and butter more cheaply than any other concern, for the latter would have to provide separate facilities. The International Harvester Company, whose salesmen call on implement dealers in the routine course of business, can market and service a full line of farm implements much more cheaply than could half a dozen separate companies, and can provide much better service. But all this merely suggests that in some economic functions competition is very wasteful, and that complete monopoly could operate more cheaply if it could maintain its efficiency. It should be a government monopoly, however, for a private monopoly would not be likely to pass economies on to consumers.

Combination in its general aspects

Passing now from the blurred distinction between horizontal and vertical combination and recognizing that most business combinations represent both forms to some extent, and often complementary combination as well, we next consider some of the problems related to the size of business, without regard to its form. In doing so we must bear in mind the fact that big business usually embodies some form of combination, and perhaps several.

Big enterprises, big combinations, absorbed a generally increasing proportion of the country's business up to 1919, and probably have grown somewhat since then. Thorp, Humphrey, and Porter find an increase in the average size of establishments between 1919 and 1929 in terms of the value of products. While the picture is somewhat confused, it is clear that in general there has been a growth in the relative importance of the giants, and a decline in small business.[12]

There were, in 1935, about 30 "administrative units" with assets of over a billion dollars, some of them properly described as combinations.[13] (See table on page 120.)

Combination and promoters' profits

Many combinations have been formed for the sake of the promoters' profits to be made thereby. In the promotion of eight steel combinations prior to the formation of the United States Steel Corporation, the promoters acquired stock with a nominal value of $63,000,000 and an actual market value of more than $28,000,000; and in the formation of the United States Steel Corporation the promotion syndicate received stock with a par value of

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[11] *Monograph No. 21,* p. 120.

[12] Temporary National Economic Committee, *Monographs No. 11, 27;* Twentieth Century Fund, *Big Business: Its Growth and Its Place.*

[13] From National Resources Committee, *The Structure of the American Economy,* Part I, pp. 100, 101.

	Assets (Millions of Dollars)	Number Employed (Thousands)
Industrials		
Standard Oil Co. (New Jersey)	1894.9	50
United States Steel Corporation	1822.4	193
General Motors Corporation (estimated)	1491.9	212
Public utilities		
American Telephone and Telegraph Co.	3998.3	270
Consolidated Edison Co. of N. Y., Inc.	1377.0	45
Commonwealth and Southern Corporation	1173.8	. .
Associated Gas and Electric Properties (estimated)	1125.4	20
Cities Service Co.	1113.2	...
The North American Co. (estimated)	1042.6	...
Railroads		
The Pennsylvania R. R. Co. (estimated)	2863.0	109
The New York Central R. R. Co. (estimated)	2356.0	95
Allegheny Corporation (estimated)	1739.0	.
Southern Pacific Co.	1677.7	37
Great Northern Ry. Co. (estimated)	1152.1	16
Northern Pacific Ry. Co. (estimated)	1131.2	17
Baltimore and Ohio R. R. Co.	1118.3	35
Atchison, Topeka and Santa Fe Ry. Co.	1091 6	42
Union Pacific R. R. Co.	1069.6	30
Banks		
Chase National Bank	2350 5	...
National City Bank	1880.7	...
Guaranty Trust Company	1847 4	. .
Bank of America National Trust and Savings Association	1277.4	...
Continental Illinois National Bank and Trust Co.	1141.1	...
Bankers Trust Co.	1031.7	...
Other financials		
Metropolitan Life Insurance Co.	4234 8	48.5
Prudential Insurance Co.	3129.5	38.6
New York Life Insurance Co.	2243.6	...
Equitable Life Insurance Society of the United States	1816 2	
Mutual Life Insurance Co. of New York	1239.0	
Northwestern Mutual Life Insurance Co.	1072.0	1.7

$129,997,500 and a market value of $62,500,000, one-fifth of which went to J. P. Morgan and Company as syndicate managers, the balance being distributed among that firm and the other members of the syndicate. In the organization of the American Tobacco Company, which had assets of only about $15,000,000, "water" to the amount of $10,000,000 was pumped into the capital structure, apparently as promoters' profits. The promoters of the American Can Company made a profit of about $8,000,000 for combining plants actually worth around $23,000,000. The banker-promoters of a cement combination received about $5,400,000 for consolidating companies whose net worth was approximately $16,000,000. Most such profits were in the form of stock in the combination, whose market value of course followed the vagaries of the stock market, and the promoters had some expenses and perhaps assumed some risks. Not all of them made profits comparable to those mentioned here, but the promotion business has often been exceedingly profitable.[14]

Combinations, research, and patents

The large concerns are in a much better position to patent and use new devices and processes. It is often very expensive to patent new inventions and fight off infringements, for the patent business is conducted according to the law of the jungle; and the owner of a patent should be able to fight infringements to the last ditch, or the highest court. Since this costs a great deal, as much as one hundred thousand dollars in some cases, a large concern can best stand the expense. It can also better afford to perfect new inventions and to experiment with new devices and methods.

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[14] Eliot Jones, *The Trust Problem in the United States*, chap. 12; Temporary National Economic Committee, *Monograph No. 13*, pp. 103, 159.

To an increasing extent inventions are the product not of individual research but of cooperative research carried on in well-financed laboratories. The field of industrial knowledge has been so extended in recent years that it is generally impossible for one man, or even a small group of men, to master the innumerable technical details in each of the scientific fields involved in research projects. In research as elsewhere, the trend has been away from individualism toward more elaborate organization; and here the giant combinations have important advantages. Some of the largest laboratories have annual budgets of several million dollars, and a few great combinations carry on a disproportionate amount of the work. According to one study, the 13 companies with the largest research staffs employed in 1938 one-third of all research workers, as many as were employed by the 1583 companies with smaller staffs included in the survey. The expenditures for research have increased rapidly in the past two decades—133 per cent from 1927 to 1938.

The smaller companies usually cannot support extensive research departments for several reasons. In the first place, adequate laboratories cost too much. The General Motors Corporation is said to have spent some $25,000,000 in several years of research and experimentation before it put the two-cycle Diesel engine on the market, and it continued the research in order to improve it. No small company could well afford such an expenditure. In the second place, the results of such work are too uncertain. A research staff may work for years on a given problem without producing any worth-while results, and they may never develop anything of real value. This the big combination can stand, because in the long run the successes presumably balance the failures; it is analogous to the advantage of the big mining corporation over the individual prospector. Since the findings of the research laboratories belong to the companies that pay the bills, research has tended to strengthen the position of the big combinations that can afford to carry on such work.

In a few cases, the research work of these combinations has developed important new industries. The electric refrigerator is partly a product of research studies carried on by great automobile and electrical concerns. Two of the widely used refrigerators are manufactured by automobile companies—Frigidaire by General Motors, and Kelvinator by Nash—and two of the others are made by giants in the electrical field, General Electric and Westinghouse.

The net social gain resulting from research work cannot be ascertained, for the public does not know much about the research operations of big combinations, or about their use of such discoveries as are made. The amazing improvements in automobiles, tires, and radios over the past two or three decades have been the results of research and experimentation, and the public has benefited a great deal; but there is another side to the picture, as Myron W. Watkins points out: "I am not unmindful of the support of industrial research by certain outstanding representatives of industrial consolidation. But in the first place much of this effort represents a defensive strategy. It is designed for 'fencing in' a field of enterprise, not for 'opening up' one. To a very considerable extent it represents a means of blocking the introduction of new technological expedients, not only through control of strategic patents, but especially through limiting the potential 'demand' for outside, or independent, inventions."[15]

Fetter is likewise rather suspicious of some of the research work done by the great combinations:

> The claim that more and better research to improve products can and does result from great combinations was one of the earliest and has been one of the most persistent. But grave doubts hang over such a claim. The subject is in need of much completer study. The United States Steel Corporation, for which this claim was strongly made at its inception, was long a notorious laggard and all the

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[15] Temporary National Economic Committee, *Monograph No. 13*, p. 99.

significant advances in metallurgy, mostly the development of alloys, for a quarter of a century were made by the comparatively small companies. Some of the most epoch-making inventions of our times have come from independent laboratories, such as that of Thomas Edison, or have been merely the last steps taken in the application of pure science discovered at the universities or by scientific workers of the Government. Most hopeful, too, are cooperative plans of research by small industry. By and large, large combinations seem to have exerted themselves far more in buying up patents for use or suppression than they have in leadership of research and invention.[16]

Whatever the balance of social advantage from this research work, the large combinations have great *competitive* advantages in patenting inventions and processes, and in fighting infringements. Patents, however, are essentially monopolies, and this will therefore be considered in connection with monopoly.

Are combinations really efficient?

Altogether, the available evidence indicates that such advantages as the giant combinations have lie rather largely in whatever monopoly power they have, in the fact that they do not always compete on even terms. There is considerable evidence that they are not particularly efficient, and, unless they have monopoly control, not unusually profitable except to the insiders who manipulate the finances. Dewing's study of 35 combinations formed between 1890 and 1904 indicated that the earnings of the constituent companies were about one-fifth higher before consolidation than afterward. The earnings of the units that make up the United States Steel Corporation, in the ten years following consolidation, were 15 per cent lower than they had been before.

A number of studies have indicated that the very large combinations made smaller profits than the medium-sized or moderately large corporations. A fairly recent report of the Federal Trade Commission draws the following conclusion: "The results of the total tests reveal that the largest companies made, on the whole, a very poor showing. . . . Certain efficient medium sized units—and in some industries certain efficient small units—generally made the best showing. Furthermore, in the tests of group efficiency, the corporations grouped as medium sized or small sized had predominantly lower average costs of production or higher rates of return on invested capital than the groups of large-sized corporations with which they were compared."[17]

Henry C. Simons is similarly unconvinced of the superior efficiency of giant concerns: "The efficiency of gigantic corporations is usually a vestigial reputation earned during early, rapid growth—a memory of youth rather than an attribute of maturity. Grown large, they become essentially political bodies, run by lawyers, bankers, and specialized politicians, and persisting mainly to preserve the power of control groups and to reward unnaturally an admittedly rare talent for holding together enterprise aggregations which ought to collapse from excessive size."[18]

The management of giant corporations

The reason for the relatively poor showing of the giant combinations appears to lie largely in the difficulty of managing very large concerns. The president of a machinery company expressed the idea rather graphically: "If I am running a business I know all about it. It has been said by people who are pretty good manufacturers and merchants that when a business gets too big for one head to manage it is not managed, and I think that is so. There have been a great many different kinds of business consolidated, and sometimes for a while they are successful, but if you will carefully watch them you will find they are not successful unless the man at the head is a good deal better than the average run of men."

Alfred Sloan, president of General Motors Corporation, has complained of the difficulties in managing his own business colossus:

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[16] *Ibid.*, p. 109. For a more favorable view of corporation research work, see T.N.E.C., *Monograph No. 27*, pp. 648 ff.

[17] Temporary National Economic Committee, *Monograph No. 13*, p. 10. This entire bulletin is devoted to the "Relative Efficiency of Large, Medium-sized, and Small Business." See also *Monograph No. 21*, pp. 311 ff.; and Twentieth Century Fund, *Big Business: Its Growth and Its Place*, and *How Profitable Is Big Business?*

[18] American Economic Association, *Papers and Proceedings*, March, 1943, p. 435.

> In practically all our activities we seem to suffer from the inertia resulting from our great size. It seems to be hard for us to get action when it comes to a matter of putting our ideas across. There are so many people involved and it requires such a tremendous effort to put something new into effect that a new idea is likely to be considered insignificant in comparison with the effort that it takes to put it across.
>
> I can't help but feel that General Motors has missed a lot by reason of this inertia. You have no idea how many things come up for consideration in the technical committee and elsewhere that are discussed and agreed upon as to principle well in advance, but too frequently we fail to put the ideas into effect until competition forces us to do so. Sometimes I am almost forced to the conclusion that General Motors is so large and its inertia so great that it is impossible for us to really be leaders.[19]

Clair Wilcox has summarized the difficulties of managing great combinations as well as anyone:

> But size, both in the unit of operation and in the unit of control, has its disadvantages. A business may become so big that no man can manage it efficiently. It may present so many changing problems that no single mind can hope to comprehend them. It may be so vast, so scattered, and so diversified that no one can really know what is going on. Under these circumstances, the manager is forced to obtain his information from accounts and statistics, to issue orders from a distance, and to rely upon paper controls. He may be bogged down with memoranda, reports, and routine. He may hesitate to make decisions and waste time in interminable delays. His subordinates may be more concerned with their own advancement than with the welfare of the enterprise. They may be entangled in red tape. They may fail to act decisively because they fear to be reversed. They may shift responsibility to others and waste further time in lost motion and internal conflict. The whole organization may be beset with nepotism, political maneuvering, factional warfare, and petty jealousies. So efficiency may be sacrificed to size and managements may grow lax or take refuge in inflexibility, resisting adjustment to changing conditions and refusing opportunity to new blood and new ideas.[20]

Social significance of giant combinations

Whether the giant business combinations are more or less efficient than smaller units is by no means the most important question that their growing dominance raises. Far more important is their general social significance. Too much economic power is centered in too few hands. Any mistakes of judgment on the part of these few men may have widespread effects on the entire economic system, for these men have vast power over jobs, wages, and working conditions, and their decisions to reduce or expand operations may have much to do with general business conditions, with the ebb and flow of the business cycle. Even more serious is the fact that these great economic principalities constitute an anachronism in what we assume to be a system of generally competitive capitalism. If the assumption of competition is to be valid, there should be a considerable number of competitors, not too unequal in power, competing in a free market in most fields of economic activity. Clearly these giant combinations, dominating most fields of enterprise to a greater or lesser extent, do not fit the general conception of competitive capitalism. Can we view with indifference the concentration of so much power in a few hands, or must we concede that our economy is no longer predominantly competitive and work out a new economic philosophy to fit the facts? These are crucial questions that must be answered one way or another, but they will be discussed in a separate chapter.

QUESTIONS

1. Give reasons why horizontal combinations have often been unprofitable. Even if they had been profitable should they be encouraged? Why or why not? Why do vertical combinations make possible more real economies?
2. The big department stores have been losing ground, relatively, for some years. Why?
3. The heavy cost of technical research tends to increase the amount of monopoly in our economy. In what ways?

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[19] Temporary National Economic Committee, *Monograph No. 13*, pp. 113–114, 130–131.

[20] Temporary National Economic Committee, *Monograph No. 21*, p. 310.

4. Mr. Charles F. Kettering, head of the research department of the General Motors Corporation, says that 99 per cent of the workaday research projects prove to be failures, but that on long-range projects the record is somewhat better. With so large a proportion of failures, why would even a large corporation carry on research? What might happen to a small concern that tried to maintain an expensive research department?
5. In what way does the increasing use of expensive and highly specialized machinery tend to increase the size of plants?
6. Some of the advantages of big plants, and even more particularly of big financial units, are largely competitive advantages, not advantages from the point of view of society as a whole. Explain.
7. The development of large, specialized machine-building concerns probably tends to make industry more competitive. How?
8. Why do not the great flour milling corporations take over vast areas of farm land and so integrate their business, as the oil companies do with crude oil production? Would it not be profitable?
9. Why are nearly all retail stores, even chain units, rather small? Why cannot a custom tailor shop attain the size of a great clothing manufacturing plant?
10. What are some of the forces that resulted in the growth of large-scale plants? What factors brought large financial units in a later period?
11. Why should we not have large firms of physicians, perhaps hundreds of them in one concern, with all the business arrangements in the hands of a business manager and the doctors rendering nothing but professional service?
12. If the number of concerns continues to decline and the average size continues to increase for another hundred years, we shall have monopoly in nearly every field of production. What will be the appropriate policy for our government if this happens?

Chapter 10.

Monopoly

"'Th' trusts,' says he, 'are heejoous monsthers built up be th' enlightened intherprise iv th' men that have done so much to advance progress in our beloved country,' he says. 'On wan hand I wud stamp thim undher fut; on th' other hand not so fast.'"

—Theodore Roosevelt, as reported by Mr. Dooley

Monopoly defined

Monopoly is difficult to define. We shall follow the general tradition, and define it as *control over the supply and price of a commodity or service*, but with the warning that this definition is too precise for a concept as vague and relative as monopoly. At one time many students of monopoly thought of it as a fairly definite concept and contrasted it with competition as if the two were clearly differentiated, as if all businesses could be definitely classified as either monopolistic or competitive. Today economists recognize that the concept of monopoly is always relative and never absolute, that there are all gradations of control over supply, from the absolute control exercised by some public utilities—the telephone company, for instance—to the slight control of an oil producer who, let us say, produces one per cent of the total output. Every producer controls part of the supply of his product, perhaps an infinitesimal part, and therefore is to that extent a monopolist. This suggests that there is at least a slight taint of monopoly in all business, or, to turn this around, that there is no purely competitive business.

Control over price is an even more indefinite and variable concept. No producer, however complete his control over supply, has unlimited control over price. Even the telephone company cannot raise prices without losing subscribers. There are all possible variations in the control of price, from that exercised by the telephone or electric monopoly, which furnishes an almost indispensable service, to that by the farmer, who can have only an infinitesimal influence on the price of his product because there are a million other farmers whose produce is a perfect or almost perfect substitute for his own. This will be discussed more fully in a later chapter, but for the present the student is warned against the common notion that monopoly is something definite. There is no pure monopoly and there is no pure competition.

There are other difficulties in the way of clear and precise definition. Monopoly (from *monos*, one; *pōkin*, to sell) strictly speaking, refers to control by a *single seller;* yet the term is commonly applied to either selling or buying, and to control by a single unit, by a few, or by many, acting in some sort of unity in their control. Economists often use the ungraceful term *monopsony* to mean monopoly in buying. Finally, confusion arises from the fact that the word monopoly is used sometimes to indicate the *power* to control output or price, and sometimes to indicate the *business concern or concerns* that have this power. Thus the Standard Oil Company is said both to *be* a monopoly and to *have* a monopoly. Only the latter is strictly correct, but the former is used so often that it has at least the warrant of common usage and is difficult to avoid consistently.

History of monopoly

During much of man's past history, monopoly has been more characteristic of economic life than has competition. It has prevailed in various forms at different times, and in many forms at almost all times. In the ancient world—Egypt, Phoenicia, Rome, and Byzantium—monopoly, particularly in the form of state and privileged monopolies, dominated economic life to an extraordinary degree. Only in Athens was economic life generally competitive for a while, for the Athenians were rugged individualists who regarded monopoly as a conspiracy against the state punishable by death. In the Middle Ages, industry was again largely dominated by privilege and monopoly exercised by the monasteries, the lords, and the military orders; and in the late medieval and mercantilist period the French and English governments set up a host of privileged monopolies to carry on business and trade, particularly with the colonies. The first colonies in America were established by noble proprietors or privileged companies; but from the first the colonists were hostile to monopoly and granted such privileges only to businesses that were definitely of the nature of a public utility. It was at these privileged English companies that Adam Smith railed in his *Wealth of Nations* in 1776.

Although prior to the Civil War there were no large monopolies in the United States, except the railroads and a few public utilities, the people suffered from exploitation both by these monopolies and by *local* monopolies in banking and retailing and in the purchase of the farmers' products. For a few years after that war the situation was much the same, but with the completion of the transcontinental railroads, the development of better farm machinery such as the harvester, the rapid growth of the flour-milling, meat-packing, oil, and steel industries, and the rise of public utilities, the seeds of big monopoly were being broadcast in the land. There had been pools in the cordage industry even before the Civil War, and in the following years a number of pools were organized in the anthracite, salt, whisky, gunpowder, and several other industries. Within ten years of its founding in 1870, the Standard Oil Company had attained a strong monopoly position which gave it control of between 90 and 95 per cent of the country's refining business. The success of that company led to combinations in many other lines of business; indeed, in most of the industries using large amounts of capital there were more or less successful attempts to organize monopolies during the last two decades of the nineteenth century.

Forms of monopoly

Monopoly may take the form of a single unit, or of multiple units working together to control output or prices. Single-unit monopolies may assume the form of trusts, holding companies, or mergers, or they may be found in the holders of patents or in small local concerns. Multiple-unit monopolies may achieve their power by means of price agreements or price leadership; pools for the sharing of profits, production, markets, raw materials, or territory; cartels, full-line forcing, trade associations, or racketeering. We shall consider the forms of monopoly in the order given.

Single-unit monopolies

Trusts. In a trust, a *board of trustees* does not buy outright but secures control of enough of the stock of each of the member companies to enable it to control their operations. The Standard Oil Company was organized as a trust in 1879, and other industries soon adopted the scheme. The business practices of these trusts led to a strong public clamor against monopolies, to the enactment of the Sherman Anti-Trust Act in 1890, and to numerous state anti-trust laws and judicial prosecutions. The Supreme Court of Ohio ordered the dissolution of the Standard Oil trust, but its astute managers evaded the decree and later reorganized as a holding company. Strong public feeling put a definite end to the organization of trusts by the close of 1903.

Holding companies. A holding company is a modification of the trust, the difference being that instead of a board of trustees, a *separate corporation* or *holding company* is formed to buy at least enough of the stocks of the various member companies so that it can control their policies. During the trust era this form of organization was generally held illegal, except in the case of a few such companies created by special statute; but in 1889 the state of New Jersey, with a greedy eye on the revenue to be gained from incorporation fees and taxes, passed a law authorizing the creation of holding companies. Outlawed trusts and promoters who yearned for monopoly privileges went to New Jersey to enjoy the new freedom until other states saw the opportunity for income and passed similar laws. The holding company remained popular from about 1900 until 1904, when the Supreme Court, in the Northern Securities case, held a railroad holding company illegal. The Clayton Act of 1914 forbade holding-company control of competing companies engaged in interstate commerce where it had the effect of substantially reducing competition, restraining commerce, or creating monopoly; but this prohibition was never effectively enforced. The holding-company form has been used a great deal down to the present time, particularly in public utilities. A number of the railway systems, the American Telephone and Telegraph Company, the United States Steel Corporation, and many public utility corporations are organized as holding companies.

Mergers. With trusts and holding companies under nominal government disapproval, mergers have become increasingly common in recent years. Between 1922 and 1928 there was a steady increase in their number—from 67 in 1922 to 221 in 1928—and this trend has persisted. A *merger* is a combination of two or more corporations, in which one corporation buys all the stock of the others and dissolves them entirely; an *amalgamation* is a combination in which a new corporation is formed to buy the stock of all the member corporations, whereupon they are dissolved as separate identities. The result in either case is a single larger corporation. Although it does not necessarily have a monopoly in the industry, it often has a measure of monopoly power. Many of our present giant corporations are the result of mergers.[1]

Patents. A patent is a monopoly granted by the government for a term of seventeen years to encourage improvements in methods of production. Between 1900 and 1933, the Patent Office issued 1,330,000 patents, most of them of little or no worth but a few of great value; in 1937 alone, a total of 43,271 were granted. Some of the big corporations own hundreds and even thousands of patents which they use or merely hold for one reason or another, perhaps to prevent others from using them.

A patent is in some respects merely a logical extension of the concept of private property, an extension granted by the government to encourage invention, just as the general right of property is guarded to encourage productive labor and saving. If a man owns a house, no one else can use it if he uses it; but in the case of an invention, there may be a thousand or ten thousand duplicates, and anyone who can secure one has the "use" of the invention. If the inventor is to have control of his invention he must control all the duplicates of it; that is, he must have a patent giving him entire control over its use.

A patent is like a brand or trade-mark in some respects. For example, the manufacturer of Gold Dust has a trade-mark covering his product, a trade-mark which no other producer may use; but if there is no patent covering Gold Dust or the process of making it, anyone may duplicate the powder and sell it under another name. Only Swift & Company may market hams as "Swift's Premium," but any meatpacking company is free to process and sell hams exactly like these unless Swift & Company have a patent on some product or process essential to their production. Thus the patent confers a greater measure of monopoly power than a brand or trade-mark, but the end sought is fundamentally the same—improvement in the products available to consumers. The patent is issued to encourage invention; the brand or trade-mark is granted to encourage the producer to improve his product. That, at any rate, is the theory of the matter.

The owner of a patent is a monopolist with respect to his own patented device or process for a period of seventeen years, but of course he has no monopoly on the development of inventions, even in the field covered by his patent. Some inventions, like the Burton cracking process owned by Standard Oil of Indiana, have brought in handsome profits, but the vast majority prove worthless. If there were any general net profit in research, presumably more money would be devoted to it. Although theoretical analysis thus leads to the conclusion that there can be no such profit from patents, this analysis does not take into consideration the extent to which patents are used to reinforce the monopoly power of industrial monopolies. Combinations of patent monopoly and industrial monopoly certainly do yield profits, but what proportion of these profits should be attributed to the patents cannot be determined.

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[1] Twentieth Century Fund, *Big Business: Its Growth and Its Place*, p. 31.

In some cases producers have set up *patent pools*, with systems of *cross licensing* by which each producer's patents are made available to the other members of the pool. Automobile manufacturers have used this system since 1915. Such a scheme apparently involves the abandonment of the advantages of private patents, as far as the members of the pool are concerned, and makes the automobile industry more definitely competitive than it would otherwise be. The fact that this industry has made rapid technical progress under the system suggests that private patents may not be as essential to invention and technological progress as they are sometimes claimed to be. The major oil companies use something similar to patent pools, each of the member companies holding stock in the patent-holding corporation and using the patents on certain stipulated terms. The Radio Corporation of America is essentially a pool of the several thousand patented devices used in the manufacture of radios.

Patent pools may, however, be used to weaken or destroy non-member concerns and to prevent the establishment of new and independent businesses; and they have been thus used, particularly in international cartels. Refusal to grant patent licenses to outsiders may be a very effective way of stifling emerging competition. Even if the patents themselves are of doubtful validity, the members of the pool may be able to prevent outsiders from using them through threats, boycotts, and harassing litigation.

The patent system probably embodied a wise policy at one time, but in recent years it has been abused in various ways and to some extent has been perverted from its original laudable purpose of stimulating invention. In the first place, owners of patents are often able to maintain their monopoly, long after the expiration of the orignial patents, by patenting improvements from time to time, and sometimes by less defensible methods. The United Shoe Machinery Company, for instance, has kept expired patents alive by the famous "tying clause," which requires shoe manufacturers to lease all their machines from the company, those on which patents have expired along with those on which the patents are still alive.

In the second place, the price paid by corporations for valuable patents is likely not to represent their real value if the inventors are persons of small means. Through some process of legalized banditry, the patents may be secured for little or nothing; or if this means proves impossible, the corporations frequently are able to prevent the owners from making any use of them. In the hands of a man of modest financial resources, a patent is likely to be of little value, even if it covers a greatly improved device. His only market may be a big corporation or combine which has its own patented devices that it is loath to scrap and replace with new ones, even if the latter are much better, but which will spend thousands of dollars in lawsuits to prevent anyone else from using his new patented device. The writer once knew a man who designed an automobile headlight that was much better than any then used, but the automobile manufacturers were apparently not interested in better headlights, and the man never realized anything from his invention. A small concern that uses a patented device or machine or process similar to one controlled by a big corporation is likely to find itself harassed by lawsuits, even if its patent is perfectly good. The legal and technical questions that arise in a patent suit are often exceedingly complicated, and such a suit can be drawn out almost indefinitely, or at least until the funds of a poorly financed litigant are exhausted. The genuine validity of the patent may not be a very important matter; a wealthy corporation can often "law" a small concern out of business in a patent suit. This is well illustrated by the testimony of a small producer of milk bottles in Texas, who was sued for patent infringement by the Hartford Company, which monopolized the field:

> We naturally were finally forced to hire a patent attorney. We had to acquire the services of a Texas attorney, and I think there are some two or three patent attorneys in the State. They brought us into court in April of 1935, as I recall. Well, when I arrived at San Angelo and met them there in the hotel, I can conservatively say that there was half a train load of attorneys and equipment. There were motion picture projectors and attorneys all over the place. I don't know anyone of the Hartford legal staff that was not there. They were prepared to give us a nice battle. Well, I had only one attorney, and he was considerably lost in the crowd. I wish you might have seen his face that morning. So I promptly asked for a recess until the afternoon, in order to see if we couldn't settle the case out of court.[2]

Whatever the equities in this particular case, it illustrates the power of big monopolies in contests with small companies—monopoly power, not superior efficiency in fair competition.

In the third place, as we have seen, patents, held mostly by great corporate combinations often reinforce the monopoly power of such combinations. Ownership of patents has been an important factor in the development of such monopolies as the Singer Sewing Machine Company, the Aluminum Company of America, the Maytag Washing Machine Company, the United Shoe Machinery Company, the American Can Company, the American Tobacco Company, and the Standard Oil Company; and it has increased the amount of monopoly in the production of motion pictures, steel wire, aluminum, photographic materials, and dozens of other important products.[3]

In the fourth place, the patent system operates to some extent not to stimulate new inventions but to enable powerfully entrenched interests to "fence in" their monopolies and prevent the introduction of new devices and processes. The research departments of large monopolies devote some of their time and effort to seeking out possible competitive improvements and tying them up with patents so that no other concern can use them. The du Pont Company once developed a pigment which could be used as either a paint or a textile dye; but because it wished to prevent its use as a textile dye lest this depress the prices of textile dyestuffs, the company set its laboratory to work on the task of discovering a process that would make this pigment unfit for use on textiles.

Small local monopolies. Although they are less common than they were a few decades ago, local monopolies are sometimes found in small towns where the total production or sales are too small to permit more than one plant to operate at lowest cost. Under such conditions monopoly is practically inevitable, because if the business were divided among several producers, they would all operate at high cost, and any producer who managed to get a little ahead of the others would have lower costs, which would enable him to take still more business away from his competitors until he got it all. Such conditions are fairly common in small towns among banks, newspapers, hotels, garages, grain elevators, lumberyards, creameries, and even grocery and general merchanise stores. The automobile has, of course, brought more competition into small-town merchandising, for many customers can now go to larger towns if they think local prices are too high. A monopoly business in a small town cannot ordinarily take much advantage of its position, for it is confronted not only with an elastic demand on the part of consumers who may go to other towns to buy but with increasing costs if it raises its prices and reduces its output. Owners of such businesses must usually content themselves with modest incomes, perhaps lower than those made in larger towns; but occasionally they build up considerable fortunes.

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[2] Temporary National Economic Committee, *Monograph No. 21*, p. 77; see also A. R. Burns, *The Decline of Competition*, pp. 11–17.

[3] Cash registers, radios, glass containers, canned milk, certain kinds of cheese, optical glass, gypsum board, asphalt shingles, hardboard, mineral wool, telephone equipment, electric lamps, electrical accounting machines, air brakes, sulphur, and many other products.

Multiple-unit monopolies

Price agreements. In very few industries except public utilities is production controlled by a single concern, by a "monopolist" in the strict sense. In most industries there are a few or in some cases many producers, who, if they are to control prices or production, must employ some scheme of cooperative action. One of the common devices for this purpose is price agreements. A single monopolist who controls a given product can of course set his own price, or, what amounts to the same thing, determine his own output; but where there are several producers they must have agreements, either explicit or informal—"gentlemen's agreements"—that establish uniform prices for all of them. The Federal Trade Commission has reported such agreements among producers of a score or more products.[4] For making such agreements, the federal Department of Justice has filed suits against the milk distributors of Chicago and the producers of newsprint on the Pacific coast, and against manufacturers of tobacco products, typewriters, ophthalmic lenses, frames and mountings, hardboard, insulation mineral wool, and aircraft fabric.

Without doubt, price agreements are rather common, for trade associations have often tried to get their members to maintain uniform prices. "When the Denver office of the Bureau of Reclamation opened 17 bids for reinforcement bars, 14 of them were for $1144.16. When the United States engineers at Los Angeles opened 12 bids of the same product, 11 of them were for $194,051.89. When the purchasing agent for the Fort Peck Dam opened 10 bids, each of the 10 was for $253,633.80. When the Navy Department opened 40 bids for cement, each of them was for $17,148.60. . . . The Consumers' Advisory Board of the N.R.A. found more than 200 such cases affecting nearly 150 products sold by more than 50 industries in 1934."[5] When Secretary Ickes called for bids on cement for the construction of Boulder Dam, ten leading companies made identical bids of $1.29 per barrel, and the Secretary secured concessions from this price only by threatening that the government would build its own plant.[6] Doubtless the builders of warships are usually in friendly agreement on the bids they submit to the government. In many towns in which there are more than one bank, the bankers have what might be called a gentlemen's agreement on problems of policy, such as the rate of interest to be charged borrowers; and lumbermen, plumbers, owners of motion-picture theaters, and some other businessmen are likewise inclined to be "gentlemen" in business affairs.

For a few heavy products, such as steel and cement, monopoly price control is made effective by what is called the *delivered-price system* or the *basing-point system.* In the steel industry, for instance, prices of steel products were once quoted on the basis of the *Pittsburgh-plus* system, that is, the Pittsburgh price plus the cost of shipping from Pittsburgh as a *basing point.* According to this scheme, a Chicago contractor who bought steel from the steel mill at Joliet, Illinois, was charged the Pittsburgh price plus freight costs from Pittsburgh, although his steel was actually shipped only about thirty miles. In this way prices were maintained at a uniform level and competition was fairly well trussed. On orders of the Federal Trade Commission, the United States Steel Corporation later added other basing points, but price control was still maintained. Cement producers have also used the basing-point system.

Price leadership. In industries in which there are only a few producers, what is known as *price leadership* has tended to supplant price-fixing agreements as a means of making monopoly control effective. Price leadership may be employed without any formal agreement, the leading producer setting the market price and the others following it. The smaller producers are almost forced to accept his price, for if they cut below it he may start a price war and ruin them. This method of price control has been used widely.[7]

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[4] Viscose rayon yarn, turbine generators and condensers, liquid chlorine, medical cotton goods, calcium chloride, corn cribs and silos, waterworks and gas fittings, fire-fighting equipment, rubber heels, plumbing supplies, fertilizer, metal lath, gasoline, and brushes, among others.

[5] Temporary National Economic Committee, *Monograph No. 21,* p. 301.

[6] *New Republic,* May 17, 1933, p. 2, and July 12, 1933, p. 220. See also the Federal Trade Commission's first report on price bases, published in 1932.

Pools. The pool, one of the first forms of monopoly control, flourished particularly in the 'seventies, 'eighties, and 'nineties, and was used in a number of industries.[8] About the end of the century, however, it was held illegal, and it is less common now. It has taken several different forms.

1. One form has called for a division of the *earnings or profits* among the members, as in the case of railroads that run between given cities.

2. Pooling has sometimes involved an allocation of *production, sales, raw materials, or territory,* by which each member is given a "fair share" of the production, sales, raw materials, or sales territory, a quota which he must not exceed. Allocation of *production* has been practiced by producers of oil, steel, iron ore, copper, cast-iron pipe, nails, explosives, lumber, textiles, canned peas, glass containers, elevators, baskets, boxes, and crates. Allocation of *sales,* or *market sharing,* has been practiced by manufacturers of window glass, building materials, and anthracite, and regularly by investment bankers. There are several variations of market sharing. In one, the members of a pool in cast-iron pipe bid against each other privately for the right to fill orders at a certain fixed price; the member who got the bid had an understanding with the others that they would bid more than the price agreed on. The proceeds of these private auctions were distributed among the members of the pool. For several years the meat packers had an agreement that fixed the amount of dressed beef each packer might ship to the eastern markets; those who exceeded their quota were fined, and those who kept below it received a bonus. In some industries, particularly those involving government contracts, pools are formed for the purpose of rotating the business from one member to another. Thus a former student of the writer reported hearing his employer talking to competitors over the telephone, reminding them that it was his turn to get a certain government contract. Division of *raw materials* among members of a pool is apparently rather rare, but there is evidence that the meat packers have some agreement as to the amount of livestock they buy for slaughter. Many students of monopoly have noted the fact that the percentages of livestock bought by each of the Big Four change little from year to year, an indication that there is a gentlemen's agreement as to purchases. It is probable that the tobacco manufacturers do not compete to any great extent in buying tobacco from the growers. In both of these markets, a few powerful concerns buy from thousands of small producers, and it is almost inevitable that they should take advantage of these "little fellows" in various ways.

Pooling sometimes takes the form of a division of the *sales territory* among the members of the pool. This is widely used in the export market, and occasionally in the domestic market. For example, after the dissolution of the Standard Oil Company, the various new companies into which it was broken up divided the country into sales areas, one for each company; but competition appeared later. The same situation prevails in the motion picture business. Paramount with more than 1200 theaters, Fox with over 500, Warners with more than 500, RKO with over 100, and Loew's, with between 120 and 130, each have an assigned territory within which it operates, although there is some overlapping.

Since pooling agreements are usually informal and unwritten and since the courts have frowned on them, they are often rather unstable, unless the participants are few in number and strong financially. Where there are numerous members and some of them are weak financially, perhaps burdened with debt, a depression is always likely to cause a break in the ranks, with the weaker brethren reaching for business on any terms; but when conditions improve, "cooperation" may again be in order. If only a few powerful concerns are involved, pooling agreements may be maintained indefinitely without difficulty.

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[7] By producers of oil, steel, anthracite, tin cans, corn products, fertilizer, canned salmon, alcohol, cement, agricultural implements, copper, non-ferrous metals, newsprint, glass containers, biscuits and crackers, and cigarettes.

[8] Among these industries were the following: salt, whisky, coal, cordage, nail, gunpowder, iron and steel, meat, bathtub, bottle, brass, cast-iron pipe, cotton thread and yarn, naval stores, sugar, tobacco, and anthracite.

Cartels. In recent discussions of monopoly, particularly of international monopoly, *cartels* have often been mentioned, but with little definite indication as to their exact character. In a narrow sense, a cartel is *a cooperative selling organization* set up to enforce adherence to production quotas that have been agreed upon. There have been some such cartels in the United States, in the salt industry, in the early oil industry, and in the wallpaper industry. The Continental Wall Paper Company, established in 1898, represented the producers of 98 per cent of the wallpaper manufactured in this country. It bought the entire output of its members, fixed the selling price and output of each member, and distributed its profits among the members according to their productive capacity.[9] In the broad and more usual sense, however, cartels assume almost every form of monopoly, as we shall presently see.

Full-line forcing. In some cases, monopoly control has been achieved by *full-line forcing,* whereby the producer compels the buyer to take a full line of his products. This method has been used by moving-picture producers in "block booking," by which theaters that buy from them are compelled to contract for a certain number of films to be released within a specified time. Perhaps this system is in a measure responsible for the low level of some of the entertainment offered by moving-picture houses, for of course it makes it impossible for independent theaters to select the kind of pictures they want to show. A similar policy has been employed in radio by the National Broadcasting Company and the Columbia Broadcasting System.

Some producers require distributors to handle only their own or certain other specified products. This procedure has at times been followed by the Eastman Kodak Company, the National Biscuit Company, the United Shoe Machinery Corporation, the International Business Machines Corporation, Remington-Rand, Inc., and the International Harvester Company; by oil companies in dealing with service stations, by automobile producers in selling to dealers, and by manufacturers of a considerable number of other products. Full-line forcing reduces competition and raises prices by requiring retailers to buy the monopoly-controlled products, even when they might buy certain products more cheaply from other manufacturers. It has the effect of making it difficult for independent producers to market their products.[10]

Trade associations. Producers of many commodities are organized into trade associations. In 1940 there were more than 8000 trade associations, 2000 of them national in scope. The fourteen largest associations spend annually more than $500,000 each, and the total budget of the national and regional associations is about $70,000,000 a year; this covers various services for their members, such as the publication of figures on production, unfilled orders, stocks or inventories, and selling prices, the promotion of uniform cost accounting systems, and in some cases the promotion of price stability. Some associations follow what is known as the "open price" policy, in which prices received are published, and members may be urged not to cut prices. This has of course brought public criticism, but officials of the associations insist that there is nothing in the publication of prices to which the public should be opposed, that it merely puts competition on a higher plane by enabling all the members to set prices with their eyes open to actual conditions in the industry. As a leading lawyer expressed it, true competition can exist only where each firm can "know and fairly judge what the others are doing. The essence of competition lies in the element of *knowledge;* it is real, true, and beneficial in proportion to its *openness and frankness, its freedom from secrecy and underhanded methods.*"[11]

This is a plausible argument, but its acceptance calls for a new conception of competition. Competition implies that the sellers are ready to cut prices to get business, and are obliged to do so frequently. The publication of prices inevitably carries with it a hint that those prices should be maintained; indeed, trade associations often do not content themselves with this hint, but urge members to refrain from the "vicious practice" of price cutting. No monopolistic price fixing is intended, of course; just the elimination of "price demoralization," "chiseling," "industrial cannibalism," "destructive competition," or perhaps "cutthroat competition" or "chaotic competition"—but all competition is more or less chaotic. Or it is the maintenance of "business stability," "the golden rule in business," the "live-and-let-live" policy, the "voluntary sharing of available business"—a kind of Christian brotherhood in business, with no thought of exploiting the public but merely with the purpose of enabling all to make a "reasonable profit," a noble purpose because "he profits most who serves best."[12] In some cases the associations have even provided for the boycott of members who failed to line up.

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[9] See A. R. Burns, *The Decline of Competition,* chap. 4.

[10] Temporary National Economic Committee, *Monograph No. 43,* pp. 5, 23–29; *Monograph No. 21,* pp. 166–176.

[11] See A. R. Burns, *The Decline of Competition,* chap. 2.

Some activities of trade associations are doubtless beneficial not only to their members but to the public as well. Thus within recent years certain associations have undertaken to eliminate the worst forms of unethical competition among their members: "secret rebates, price discrimination, malicious inducement to breaches of contract, sales below cost with the intention and effect of injuring a competitor, bribery, defamation of competitors, malicious enticement of the employees of competitors, shipment of goods not conforming to samples, deceptive advertisements, and shipments on consignments."[13] The Federal Trade Commission has been used as a sort of court to decide, subject to judicial review, what practices are unethical, and is building up a line of decisions as to what constitutes ethical practices in business. Here, as in so many areas of economic activity, we see the government intervening more and more.

There is no doubt, on the other hand, that trade associations have often engaged in activities that have tended to stifle competition and to strengthen monopolistic tendencies in business. These activities have taken the form of price fixing and allocation of markets, production, and sales. In their efforts to achieve price control, these associations have frequently been assisted by "management engineers," agencies whose function is to organize, advise, direct, and in some cases manage such organizations. One such firm—Stevenson, Jordan and Harrison, of New York—administers the affairs of some thirty national trade associations whose avowed purpose is to maintain control of production and prices.[14]

Racketeering. Monopoly control may be maintained, finally, by what is called *racketeering,* a species of economic piracy which flourished particularly after the First World War. The method is generally to "protect" some line of business from competition by forcing everyone in it to join the racket; thugs and gunmen are hired to bomb or set fire to the establishments of those who refuse to join and pay the required tribute, which is often very high, or to beat up or kidnap independent operators or their employees; even murder has been resorted to on occasion. This type of terrorism was practiced widely in the bootleg liquor trade in prohibition days. Al Capone, the famous Chicago racketeer, was said to have 5000 men on his pay roll engaged in various rackets, and his total profits ran into millions. When Cornelius Vanderbilt, Jr., interviewed him, however, he disclaimed all title to greatness: "Here I am, Public Enemy Number 1, the meal ticket of shyster lawyers and bum reporters, and who am I with it all? Just a piker. The real graft goes to the bankers, to your dad's friends. Isn't it true?"[15]

Racketeering has been fairly common in various businesses. In some cities there have been racketeering combinations of labor unions and contractors to keep wages and profits high; and they are often found in the business of prostitution, sometimes with the city police and officials sharing the profits. They have often operated too in a considerable number of legitimate businesses: in that of cleaners and dyers, laundrymen, barbers, junkmen, truckers, operators of garages, service stations, and movie houses, and among distributors of ice, milk, soft drinks, fresh fruits, vegetables, poultry, and fish. There were 91 such rackets in Chicago in 1929, whose total profits ran into millions. One of the most notorious rackets was that in the live poultry market in New York City; the thugs and ex-convicts who policed the trade killed ten men in a period of five years. The profits were estimated at $2,000,000 a year, and one of the racketeers was said to receive $5000 a week for his services.[16]

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[12] Temporary National Economic Committee, *Monograph No. 18,* pp. 47–49.

[13] A. R. Burns, *The Decline of Competition,* p. 70.

[14] See S. Doc. 226, 70th Cong., 2nd sess., 1929, pp. 513 ff.; and Leverett S. Lyon, *The Economics of Open Price Systems.*

[15] Cornelius Vanderbilt, *Farewell to Fifth Avenue,* p. 172.

Conditions favorable to monopoly

Coming now to a consideration of the conditions favoring monopoly, we may say, in general, that there is usually a *tendency* toward monopoly, just as there is usually a *tendency* toward competition, and that under some conditions one tendency will prove stronger, whereas under other conditions the other will prevail. Individual businessmen may *compete* in search of profits, or if they think they can gain more by *combining* they will try to effect a combination. Where competitive conditions prevail, many businessmen will hanker for monopoly "as the hart panteth after the water brooks," and will try to get together to protect themselves from the rigors of competition. Adam Smith once said that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." Applied to the activities of modern businessmen, such a statement would be an exaggeration; but businessmen have a general aversion to competition and avoid it if they can. In a monopolized field of industry, on the other hand, there is usually a threat of competition. Businessmen outside the combination are likely to look longingly at the green pastures across the fence, and if conditions do not make it impossible they may enter into competition. Under some conditions, competition is likely to survive; under other conditions the drift to monopoly is strong if not irresistible. Let us examine some of the conditions that favor monopoly.

1. *Competition, wasteful or impossible: public utilities.* Under certain conditions, monopoly is inevitable and desirable. This is especially true in industries where competing plants represent merely expensive duplication, as in the railroad, street railway, city water, electric light, gas, and telephone industries—the public utilities. Competition has been tried in some of these industries, but it has proved to be very expensive and to provide very poor service. In towns where there were two competing telephone systems, for example, everyone had either to install two phones or content himself with connections with a single list of subscribers. Such businesses are recognized as natural monopolies and are given a monopoly franchise by the government, with provision for regulation of rates.

2. *Concentration of economic power.* The American economy, with its concentration of economic power in a few hands, offers very favorable conditions for the development of monopoly. In 1933, according to the National Resources Committee, 200 great corporations with combined assets of 95 billion dollars controlled approximately 60 per cent of the physical assets of all non-financial corporations, between 46 and 51 per cent of the nation's industrial wealth, and between 19 and 21 per cent of the nation's total wealth. Control is even more concentrated than these figures suggest, however, because these corporations are to some extent tied together by intercorporate stockownership, interlocking directorships, and interlacing banking relationships. As we have seen, wealthy capitalists often hold considerable blocks of stock in a number of corporations, and some of the directors of each big corporation serve on the boards of several others. Perhaps the most important integrating force is found in banking and financial institutions. In 1935, banks, insurance companies, and other financial corporations owned approximately one-fourth of all the bonds of American corporations, and powerful banks exert some influence in many of our great corporations.

The National Resources Committee has distinguished eight powerful "interest groups" which in 1935 had at least a certain measure of control over more than 60 billion dollars of corporate wealth: the Morgan-First National (Bank) group, the Rockefeller group, the Kuhn-Loeb group, the Mellon group, the du Pont group, the Chicago group, the Cleveland group, and the Boston group. The corporate wealth represented by these groups is shown in the table below.

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[16] Temporary National Economic Committee, *Monograph No. 21*, pp. 293 ff.

Turning to production figures, we see a similar picture of concentration of economic power.

> Among 1807 products, representing nearly half, by number, and more than half, by value, of those included in the Census of Manufactures for 1937, there were 291, or more than one-sixth of those in the sample [analyzed by the Temporary National Economic Committee], in which the leading producer accounted for 50 to 75 percent of the total supply. One company, in each field, in some year between 1930 and 1940, produced 40 percent of the Nation's output of industrial alcohol, 40 percent of the corn products, 41 percent of the farm machinery, 50 percent of the towels, 60 percent of the fruit jars, 66 percent of the canned soup, and 85 percent of the fire extinguishing apparatus and supplies. One company, in 1932, was said to manufacture 65 percent of the cinema negative film, 75 percent of the cinema positive film, and 85 percent of the still film for amateurs. . . .
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> Two companies manufactured 70 percent of the heavier types of electrical equipment, 70 percent of the electric motors, and 75 percent of the watt-hour meters made in 1923 and produced 80 percent of the distribution and power transformers and 89 percent of the generators that were in use in 1925.[17]

But such figures are tedious. In summary, we may say that in 1935, in 54 industries, some of them very important, the four largest firms produced more than two-thirds, by value, of the total output; and in 1937, of 121 products, the four largest firms produced more than three-fourths of the total output. With such industrial concentration, it is not surprising that the American economy should be shot through with monopoly. Without doubt the concentration has increased since these figures were compiled.

3. *Limitation of natural resources.* A third condition favoring monopoly is the strict limitation of certain natural resources used as raw materials. All natural resources are limited in amount, some of them to such an extent that they present conditions favorable to monopoly. If a monopoly gains control of all the iron-pipe production in the country, some concern may erect a mill and make more pipe in competition with the monopoly; but if the monopoly has all the iron ore, its control is secure. It is only natural that some of our most important monopolies hold their power by control of certain of these resources. Anthracite was at one time almost completely monopolized by a few companies which gained their interest from the railroads that originally controlled this kind of coal, and much of it is still in "strong hands." Between one-half and three-fourths of the country's iron ore reserves are owned by the United States Steel Corporation; more than nine-tenths of it is in the hands of this and three other companies. The Aluminum Company of America, controlled by the Mellon family, owns 90 per cent of the nation's bauxite supply and through its control of patents has almost absolute control of the man-

EIGHT INTEREST GROUPS AND THEIR ASSETS, 1935[18]
(MILLIONS OF DOLLARS)

	Morgan-First National	Rockefeller	Kuhn-Loeb	Mellon	Du Pont	Chicago	Cleveland	Boston	Total
Industrials	$ 3,920	$4,262	$ 0	$1,648	$2,232	$ 858	$1,066	$ 425	$14,411
Rails	9,678	0	9,963	153	0	0	0	0	19,794
Banks	4,421	2,351	548	672	396	2,595	338	740	12,061
Utilities	12,191	0	342	859	0	813	0	554	14,759
	$30,210	$6,613	$10,853	$3,332	$2,628	$4,266	$1,404	$1,719	$61,025

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[17] Temporary National Economic Committee, *Monograph No. 21*, pp. 113–114.

[18] National Resources Committee, *The Structure of the American Economy*, Part I, p. 161.

ufacture of aluminum; and the same interests have an airtight monopoly of sulphur. The International Nickel Company of Canada owns 92 per cent of all the nickel resources in the world. Molybdenum, used in the production of steels of great toughness and strength, is found almost exclusively in Bartlett Mountain in Colorado, almost all of which is owned by one company. Hydroelectric plants represent monopolies within the area they serve, and most of the water power that is not owned by the federal government is controlled by a few big concerns which are to some extent unified by interlocking directorates and other connections. In the copper industry, ten companies control 71.5 per cent of the known ore resources of the United States, as well as valuable deposits in other parts of the world. Copper refineries in any particular region are usually in a monopolistic (or, perhaps better, a "monopsonistic") position with regard to the ores produced there, because they constitute the only available market. Lead ore, like copper ore, is largely controlled by a few concerns, and one company refines and sells one-third of the output.

The acreage of standing timber has been so great that no single producer or group of producers has been able to control a large percentage of it. Nevertheless, there have been many examples of monopolistic control, usually by trade associations; and as these reserves steadily decline it seems likely that such control will increase in the future. At the present rate of cutting, our reserves will last only forty or fifty years.

The Standard Oil Company does not owe its strong position to the ownership of petroleum resources, for during the years when it was establishing its power it did not engage to any great extent in oil production but created a monopoly in the refining and transportation of oil. In recent years, however, it has invested heavily in proved oil lands; and it now has an almost complete monopoly in some regions and in most areas is the most powerful single unit in the business. Even so, it no longer holds the dominant position it once did; and the oil industry today is to some extent competitive.

4. *Interferences with trade.* Any obstacle, natural or political, to the free movement of goods into a given area tends to foster monopoly within that area. We have already seen that there are many local monopolies in small towns, monopolies which exist because those towns are shut off from other trading centers by the natural obstacle of distance. In international trade, tariffs shut out goods and foster monopolies in somewhat similar fashion. Although Havemeyer's famous dictum that the tariff is the "mother of the trusts" perhaps puts the matter too strongly, it cannot be denied that the American tariff system has encouraged monopoly. The sugar monopoly is the direct result of the sugar tariff, and the aluminum monopoly has profited greatly from the tariff on aluminum. International monopolies, like the aluminum monopoly, might prosper even without tariffs, because they divide the world market up among the producers and usually do not compete internationally, but they do even better under protection.[19]

5. *Heavy fixed charges.* A condition that prevails generally in large industries, heavy fixed charges, is a very important cause of the growth of monopoly. During the past few decades there has been a tremendous increase in the amount, size, complexity, and expense of the machinery used in most factories, and a decline in the relative importance of labor. Unlike labor costs, which can be reduced quickly by dismissing some of the workmen, the interest on the firm's investment in machinery and the cost of its upkeep, depreciation, and obsolescence represent fixed charges which must be borne by the business continuously, in good times and bad. Burdened with such costs, producers are anxious to avoid price wars in times of depression, for they know how devastating such wars can be, how hard men will fight for business when a large proportion of their costs (the fixed costs) are little affected by the amount of business. This leads them to try to effect some combination which will enable them to avoid ruinous competition, and they are likely to succeed. Perhaps it is futile to expect competition to survive in an industry in which fixed costs are extremely heavy, as in the railroads and the steel industry. In the case of the railroads, there are other reasons than this why competition is ruinous—in particular, the fact that the service is fairly well

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[19] Temporary National Economic Committee, *Monograph No. 10.*

standardized, so that a very small difference in the rates charged by two roads will throw almost all the traffic to one or the other. During rate wars between railroads that run between New York and Chicago, passengers have been carried free of all charge. Although the steel industry is not a natural monopoly in the same sense as the railroads, competition has often been so destructive that combination has seemed the only way to save the industry from ruin. As Carnegie once said, the steel industry has always been "prince or pauper"—prince when business was good and there was no occasion for price wars, pauper when business declined and the steel masters fought for markets.

6. *Monopoly as a cause of monopoly.* Monopoly has a general tendency to beget its kind, for if powerful monopolies are exploiting other producers, the latter may be driven to combine for self-protection. Some of the farm cooperatives were organized under such circumstances; the California citrus fruit producers, for instance, had been exploited by commission men for years before they organized their great cooperative association. In the industrial field, a monopoly can profit relatively little from dealing with other monopolies; and to avoid this necessity, it is likely to seek integration by absorbing sources of raw materials and in some cases the processing and marketing agencies.

7. *Public opinion.* Public opinion is a force that affects the growth of monopolies to some extent. In Germany, for example, public opinion and the policy of the government have not been overly hostile to monopolies, which probably accounts in some degree for their prevalence there. The German government itself has not only encouraged but has become a partner in some monopolies. In the United States, on the other hand, public opinion has been generally hostile to monopolies, although the government, much of the time under the control of monopolists to some extent, has not usually followed a very repressive policy.

8. *Monopoly a result of competition.* Rather paradoxically, it may be said that to some extent monopoly is the natural outgrowth of competition. According to Frank Knight: "The fact that monopoly is usually more remunerative than competitive production furnishes a powerful incentive to form such organizations, and free competition naturally tends to become a contest in the establishment of monopoly."[20] Competition is a race, and someone must win in a race, which may mean "must achieve a monopoly position." Karl Marx believed that out of competition would inevitably come the centralization of wealth in a few hands, and that the last stage of capitalism would be "monopoly capitalism." Although his predictions on this point have not been entirely justified by later developments, there is some reason to believe that competition, as it prevailed during the nineteenth century, is on the retreat.

QUESTIONS

1. Define monopoly. Where would you find pure monopoly? Where would you find pure competition? Distinguish clearly between the average man's conception of monopoly and the economist's conception of the term. What advantages are there in the latter?
2. Name some of the factors that may affect the amount of monopoly in our economy.
3. Mention some cases in which monopoly is based on the control of natural resources.
4. What various forms may pools take?
5. Why may the "open price policy" of some trade associations tend to stifle competition?
6. What kind of monopolies are less common than they used to be?
7. What are some of the possible advantages of monopoly, even in industries not properly classified as public utilities? Is it likely that these advantages will be passed on to consumers in lower prices? If so, would it be well to have all industries monopolized? Would management be efficient? Why or why not?
8. If patents were granted only to clearly competitive producers, they would not present a serious problem. Explain why.

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[20] *The Ethics of Competition*, pp. 291–292.

9. How can a monopoly keep patents alive after they have legally expired?
10. What significance can you see in the rapid improvement of automobiles under a system of "patent pools"?
11. In 1935 the du Ponts owned 5000 unexpired patents and had licenses to operate under 1100 more. Does this represent "free enterprise"?
12. Why do you think insurance companies object to federal regulation of their business, and not to state regulation?
13. The control of monopoly has not been an important issue in any recent election. Is it of no importance? Why are people unconcerned about it?

Chapter 11.

Monopoly (*Continued*)

The extent of monopoly

If some competent scholar could tell us just how much monopoly there is in American economic life, he would make a tremendously significant contribution to economic knowledge and might be able to help greatly in the solution of our economic problems. We know much less than we should about this, for a number of reasons.

In the first place, as already suggested, we cannot use absolute terms in describing monopoly. Hence our problem in determining its extent is not simply that of classifying industries as monopolistic or competitive, but of weighing the monopolistic influence in each industry. In the second place, this influence may be manifest in more than one way, perhaps by reduction in output, perhaps by the raising of prices; and the effect on output will not necessarily be the same as the effect on prices. A 10 per cent reduction in the output of certain goods might raise prices only 3 per cent, whereas the same reduction in the output of other goods might raise prices 20 per cent. Thus it might make a great difference whether we weigh monopoly on the basis of its effect on output or its influence on prices. In the third place, the economic scene is constantly shifting. Old monopolies may be gaining power or disintegrating; new ones are in process of formation; substitutes are being developed for commodities under monopoly control; new industries are growing up, perhaps competitive, perhaps monopolistic; and some are declining or perhaps passing entirely out of the picture —the railroad industry, for instance, and the manufacture of buggies and harnesses. It is difficult, in any case, for an investigator to find out much, except from records of lawsuits and court decisions and from investigations by government committees and commissions. The most thorough and comprehensive of such investigations is probably that made by the Temporary National Economic Committee from 1938 to 1941. The records of the hearings held by this committee were published in 1941 in thirty-one volumes, or parts, and six supplemental volumes. The committee then assigned various government agencies and economists the task of studying different aspects of our economic system, particularly with respect to competition and monopoly; and their work resulted in the publication of forty-three monographs. These hearings and monographs constitute a mine of information on monopoly and on various other aspects of our economic system.

Monopoly picture blurred

For these various reasons the following description is subject to many inaccuracies and its significance is difficult to appraise. Statistics on the concentration of production in a few large concerns do not indicate clearly the amount of monopoly control over prices, for it is possible, although not likely, that a few giant concerns will compete vigorously, as the rubber-tire companies did for some years. Some monopolists, furthermore, may carry on their business with some regard for the public, may refrain from squeezing the last penny of profit out of their position. Naturally, in a profit economy, most of them will do well for themselves, and some have exploited their advantage without conscience; but others have to some degree recognized their responsibility to the public.

Public utilities

Some knowledge we have. For one thing, we know something about the investment in public utilities, which are natural monopolies and have grown up almost entirely since the Civil War, largely since 1900. No American city had any public utilities at first; but when the cities grew too large to depend on wells for water, water-supply systems had to be provided. Before the Civil War, public utilities were limited mainly to bridges, turnpikes, canals, and ferries that operated under special charters granted by the state legislatures. Streetcar systems, horse-drawn at first, were introduced in the larger cities after the Civil War and were electrified in the 'nineties. Manufactured gas has been used for lighting for more than a century, but since 1900 it has been largely superseded in this country by electricity for lighting purposes, and to some extent by natural gas for other purposes. The electrical industry has grown with extraordinary rapidity since 1910.[1] With these utilities should be included railroads, pipe lines, telegraph, and radio broadcasting, which, while not strictly classed as public utilities, are natural monopolies. It is difficult to estimate the value of these latter industries, but the amount invested is not less than 20 billion dollars. The total value of all public utilities, including these, is probably more than 50 billion dollars.

Monopolized and partly monopolized industries

There are a number of industries in which one or a few concerns completely or almost completely monopolize production.[2] And an even larger number of industries are characterized by some degree of monopoly control.[3] As pointed out in the preceding chapter, in 1935 there were 54 industries in which the four largest firms produced more than two-thirds of the total product; and in 1937 there were 121 products in the manufacture of which the four largest firms produced more than three-fourths. Inevitably there will be a large measure of monopoly control, perhaps almost complete control, in such industries.

In other important businesses there is a considerable element of monopoly. Fire insurance appears to be rather tightly monopolized, and when the Department of Justice indicted certain of these companies in November, 1942, under the Sherman Anti-Trust Law, the companies answered, not by denying monopoly practices but by denying that they were "commerce" and hence could not be prosecuted under that act. In life insurance, similarly, there have been agreements limiting competition, and informal and formal agreements as to commissions and other matters. This is not in all respects unfortunate, for if the insurance business were purely or even severely competitive, there would inevitably be more failures than could be tolerated in that line. Nevertheless, by maintaining high premium rates and paying high commissions to their salesmen, these companies keep far too many men in the field, and this represents a waste of human talent for which the policyholders have to pay.

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[1] See the article on public utilities by John Bauer in the *Encyclopaedia of the Social Sciences*, vol. xii, pp. 677–683. Municipal water-supply systems are not included here because they are usually owned by the cities.

[2] Those engaged in producing shoe machinery, Pullman cars, cash registers, typewriters, electric accounting machinery, fire-extinguishing apparatus, linoleum, rayon yarn, aluminum, tungsten-carbide, photographic supplies, molybdenum, magnesium, beryllium, anthracite, iron ore, building plaster, linseed oil, nickel, sulphur, industrial alcohol, synthetic nitrogen, fertilizer, plumbing supplies, farm implements, air brakes, glass containers, heat-resistant glassware, optical glass, washing machines, sewing machines, sewing thread, electric lamps, ball bearings, heavy electrical equipment, electric motors and meters, locomotives, naval vessels, bananas, canned soup, biscuits and crackers, and transoceanic aviation and communication services. This is only a partial list, for there are others and there are many small local monopolies.

[3] Those producing steel and steel products, drugs, chemicals, oil products, tobacco, sugar, cans, plate glass, meats, some kinds of cheese, baking powder, yeast, vegetable oils, oleomargarine, chocolate and cocoa, some California fruits, cranberries, most building materials including cement, copper, brass and lead, matches, soap, automobile tires, electric refrigerators, cast-iron enamelware, vitreous chinaware, gypsum and gypsum board, cigarettes, gauze, bandages, adhesive, automobiles, boric acid, tennis balls, marine engines, zinc, asphalt, coffins, and many other products.

The distribution of milk in many cities is handled by monopoly distributors who often exploit consumers or dairymen, or both. Some of these monopolies earn fat dividends and pay huge salaries. Thus the president of the National Dairy Products Corporation was reported several years ago as receiving a salary of $168,000 a year, and a number of other officers in this and similar concerns received from $25,000 to $100,000. There is no conceivable justification for private monopoly in a business so important to public health as the distribution of milk.

Recently it has been charged that the production of vitamin D is monopolized by a quasi-public agency called the Wisconsin Alumni Research Foundation; in fact, there is evidence of monopoly in much of the vitamin production business.

The newspaper business likewise shows an element of monopoly, which, according to Dr. Alfred Lee, is increasing. Most small towns necessarily have only one newspaper because there is not enough business for more than one; in more than a thousand cities there is only one daily paper. In some cases the papers published in these various cities are owned by powerful newspaper chains. A further element of monopoly enters from the fact that the Associated Press, the largest of the world-wide news-gathering agencies, occupies a partly monopolistic position. The other agencies do not of course represent pure competition.

Labor unions as monopolies

To the list of capitalist monopolies must be added the labor unions which are in a monopoly position. Among the strongest unions are the railroad brotherhoods, including the engineers, firemen, conductors, and trainmen. The building trades—plumbers, platerers, carpenters, bricklayers, stone masons, electricians, structural ironworkers, painters, and other similar workmen—are so tightly unionized in some parts of the country that they completely monopolize employment in the building trades. However, the entire subject of labor monopolies will be considered in more detail in the chapters on labor problems.

Competitive industries

A different way of appraising the amount of monopoly in our economic life is to start with competition and see how much of the economic area is effectively competitive. Here again it is a question of "more or less" and not of absolutes, but a few generalizations may be ventured. The farming business, except for a few specialized crops like cranberries and California fruits, is highly competitive; the production of such crops as wheat and cotton represents almost pure competition. Retailing and wholesaling, carried on in about 1,500,000 enterprises, are generally competitive, even severely competitive. The service trades, covering more than a million enterprises rendering non-professional personal services, are mostly highly competitive; included here are restaurants, barber shops, automobile garages and repair shops, beauty shops, and the like. Generally competitive too are the industries producing crude oil, cotton goods, woolens, silk and rayon goods, knitted goods, men's, boys', and women's clothing, boots and shoes, leather goods, tires, many household appliances, and most food products. Fisheries, except salmon, are on the whole competitive, and the retailing of oil products through service stations is apparently so highly competitive that it is carried on at an annual loss of some $175,000,000. The bituminous coal industry is also ruinously competitive.[4]

Adding up the farmers, retailers, and other classes engaged in generally competitive business, we get a total which represents perhaps half of the country's working population, the "gainfully employed." Such a figure, however, probably exaggerates the relative importance of the competitive area of our economy, because most of these workers are employed in small businesses. The vast preponderance of capital, wealth, and income is in the monopolized area. In the matter of income, for instance, although farmers represent about 25 per cent of our total population, they usually receive less than 10 per cent of the total national income, and the incomes of retailers and service tradesmen are likewise generally small. The monopoly-controlled industries are generally profitable, some of them highly so, whereas the more competitive industries are seldom profitable and in some cases, like farming during the two decades or so before the Second World War, may be operated at a loss. As a consequence the wealth piles up in the monopolized industries through reinvestment of earnings, while the competitive industries lag or lose ground. This is by no means the only reason why farming and small retail and service enterprises have declined, but it is one reason. There is significance in the fact that most of the severely competitive businesses, such as farming, small retailing, and service industries, cotton manufacturing, and bituminous coal mining were in more or less distress before World War II.

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[4] Temporary National Economic Committee, *Monograph No. 21*, chap. 2.

Monopoly and traditional economic assumptions

The question of monopoly is being discussed rather fully in these two chapters for several reasons. For one thing, much of our economic thinking rests on the complacent assumption of pervasive competition; and to the extent that the assumption is not valid, the conclusions are likely to be unsound. Many people, for instance, assume that business success is achieved by rendering a valuable public service, such as operating a business efficiently, producing goods of high quality, or producing goods cheaply and selling them in large amounts to the consuming public; but the monopolist makes his profit partly by *restricting* production. Similarly, common belief holds that it is the energetic, capable men who survive in business; but competence is at any rate not so imperative in a monopoly-controlled industry as in a competitive enterprise. Government interference with business is often opposed on the ground that competition will adequately protect the public from inferior quality and high prices; but to the extent that monopoly prevails, the public has no such protection and government interference is needed.

Advantages of monopoly

It may be conceded, on the other hand, that monopoly under certain circumstances may offer advantages, even to the public. Public utilities, as we have seen, are "natural monopolies" and can provide better service as monopolies than they could under competitive conditions. Monopoly has so many advantages in the exploitation of oil that in most parts of the world, outside of the United States, an oil field is usually turned over to a single company rather than to a number of competing companies. A single company working a given field can exploit, refine, and transport oil so much more cheaply than several competing concerns that the oil industry has assumed many of the characteristics of a natural monopoly. Competition here involves tremendous waste of oil and capital through hasty and careless drilling, the drilling of too many wells, the excessively rapid draining of pools, the construction of too many refineries, some of them inefficient, and in other ways. It is altogether probable that the Standard Oil Company's dominance of our oil industry has been fortunate for consumers, because it has reduced waste and conserved oil resources for the future. The exploitation of timber resources in a given forest area should similarly be in the hands of a single company, for one company can cut the timber, transport it to the mills, and saw it far more cheaply than several competing companies. Indeed, this holds true in the exploitation of nearly all natural resources. The monopolist's tendency to restrict production is an advantage here in the long run, as against the tendency of competitive producers to exploit such resources too rapidly. A monopoly can organize a program of exploitation more systematically than a number of competing concerns, can avoid duplication of plants and services, and can often conserve the resources themselves more effectively, because it does not have to engage in a mad scramble to get the product to the market. The United States Steel Corporation, for example, has set a high standard in its conservation of iron ores. The exploitation of most natural resources should probably be classified as a natural monopoly and be subject to government regulation like other natural monopolies.

Monopoly has similar although less important advantages in almost any field. We have already seen that the International Harvester Company can give better service to the farmers who use its machinery than a hundred or even half a dozen independent producers could. It can and does have agents and repair men scattered throughout farm regions, and its dealers carry fairly full lines of repair parts. Because of his dominant position in the automobile industry some years ago, Ford could offer similarly complete and satisfactory service; the driver of a Ford could find good repairmen in almost any little town, with a full line of parts, which he needed rather frequently. If the meat-packing business were one big monopoly controlling meats, cheese, butter, and allied products, it could give retailers better service than the Big Four can offer, and at a lower cost, just as the Big Four can give better service than a hundred competitive packers could offer. If the grocery business in a given town or city were a complete monopoly, it could be organized in such a way as to give consumers better retail service than many competitive retailers, and still eliminate or reduce many of the wastes of monopolistic competition, such as advertising, duplication of deliveries, credit losses, and excessive inventories.

Monopoly *could* organize a business better and could secure many economies if the management were efficient; but it is not at all certain that it would remain efficient without the spur of competition. Many monopolies lapse into a phlegmatic routine of bureaucratic inefficiency not too different from that of some governmental departments and bureaus. And even if a monopoly retained its progressiveness and efficiency, there is no reason to believe that the benefits would generally be passed on to consumers through lower prices.

Monopoly and efficiency of management

Without question, some monopolies are inefficiently managed. The railroads have often been pointed out as examples of this, and with some justice, although in certain instances what seems to be inefficiency is in part due to peculiarities in the railroad industry other than its monopoly position. Under present-day conditions, for instance, there would be considerable economy in laying the rails farther apart and building the cars wider; but no railroad owner, however progressive, could alter these two factors because to do so would make it impossible for the cars of other railroads to shift to his rails and for his own cars to run on other roads. Government regulation is responsible, also, for some of the routine rigidity, red tape, and unprogressiveness characteristic of this industry. With due acknowledgment of all this, it is still true that the management of the railroads has been inefficient in many ways. Conscious of their monopoly position, many officials were until recent years arrogant and discourteous in dealing with the public, unreceptive or impervious to new ideas in management, and not above indulgence in various forms of graft; and even today the management of some of the railroads is honeycombed with corporation politics, often practiced under ethical codes quite as low as those prevailing in "political politics." The improvement shown in railroad service since competition appeared indicates the lethargy of the former management.

Control of monopoly

It is sometimes assumed that if we wished, we could break up the monopolies and restore a competitive regime; but there is little reason to hope that a trust-busting policy could accomplish much, even if it were prosecuted with vigor. A great deal was expected of the Sherman Anti-Trust Act of 1890, which declared illegal all contracts, combinations, or conspiracies in restraint of trade, and made monopolization a misdemeanor; but within ten years after its passage, the greatest combination movement in our history was inaugurated, and this law was impotent to stop it. In 1914, after several years of agitation, Congress set up the Federal Trade Commission to investigate suspected cases of monopoly and price discrimination and put an end to illegal practices; and soon afterward the Clayton Act, which redefined the offense called price discrimination, was passed. For various reasons, these laws were about as ineffective as the Sherman Act had been. The National Industrial Recovery Act of 1933 was designed to stimulate economic recovery and prevent unfair competition by establishing "codes" of fair competition for each industry. Under the codes each industry was largely self-governing; and since consumers were not represented, the code authorities sometimes found the best way to prevent unfair competition was to suppress all competition as far as possible. Thus the NRA proved to be an instrument for promoting monopoly.

In 1936 the Clayton Act was amended to define unfair practices more explicitly, and in the same year the Robinson-Patman Act was passed. This act forbids concerns engaged in interstate commerce to make price discriminations among buyers where such discrimination tends to reduce competition, except as far as it is justified by differences in costs or by certain other circumstances that are enumerated. The act was designed specifically to prevent some producers from selling goods at much lower prices to big buyers, such as the chain stores and the mail-order houses, except when it actually cost less to manufacture for or sell to these purchasers. Although it was thus intended to protect the small retailer, its effectiveness in this respect is uncertain. Certainly the government has accomplished little in the way of controlling monopolies by means of any of these acts.

It is unlikely, for various reasons, that much can be done to eliminate monopoly. In the first place, the growth of huge monopolies is one result, apparently an inevitable one, of the development of a machine technology and the integration of business on a national scale. Fundamental economic forces have reduced the area of small business and enlarged that of big business. Individual enterprise is on the wane in the face of the steady advance of corporate enterprise as embodied in giant productive and financial units that do not provide the essential basis for anything approximating pure or even effective competition.

In the second place, trust busting cannot accomplish much because monopoly cannot be defined with sufficient exactness. The Sherman Act held to the "devil theory" of monopoly, to the notion that all competitive producers are good and all monopolists are wicked. Monopoly was regarded as a definite and definable form of wickedness, and this view, as we have seen, is untenable. Monopoly control is never absolute; it prevails in all industry "more or less"; hence it is difficult to see how the courts can well draw the line between the amount that can be tolerated and the amount that must be suppressed. Furthermore, as was said earlier, monopoly takes different forms: price agreements, price leadership, mergers, and trade associations, among others. But price agreements are seldom written; price leadership presents nothing that the law can seize upon as indictable; mergers ("mere size is not a crime") and trade associations, we are assured, are engaged not in establishing monopolies but only in preventing "disastrous competition"!

A third difficulty in the way of any effective prosecution of monopoly is that the government, as generally constituted, hardly dares to prosecute anti-monopoly cases with any great vigor. Monopolies constitute the most powerful political group in the country, the group that pays a great part of the campaign expenses of both parties; and the party elected to office cannot gracefully turn on its financial supporters and prosecute them for being monopolists! Even if the federal Department of Justice were disposed to "crack down" on monopoly, it would have difficulty in persuading Congress to appropriate enough money to carry on this work effectively, for Congressmen rely heavily on campaign contributions. Anti-monopoly suits are expensive, a single suit sometimes costing as much as $150,000; and the total budget of the Anti-trust Division of the Department of Justice for 1941 was only $1,325,000. Not until 1938 were as many as fifty lawyers employed at this work, and a year later there were only 200 lawyers and half a dozen economists on the job. Single corporations may spend as much in defending a suit as the Anti-trust Division has to spend for a year's work.

Under the administration of Franklin D. Roosevelt, however, the government rose above some of these difficulties, and Assistant Attorney General Thurman Arnold initiated a rather aggressive "blitzkrieg" against monopoly. He attacked with particular vigor the international patent monopolies which he charged with hamstringing our government's war efforts; but, although he secured some surprising concessions, the general structure of monopoly power was little affected. Arnold was presently "promoted" to another job, probably in answer to the pressure exerted by monopoly interests.

Furthermore, the nature of an anti-monopoly suit is such that the government is at a great disadvantage. It often has difficulty in gaining access to the defendant's files, and, if successful, often finds them cleared of all incriminating evidence. Its witnesses, many of whom are small businessmen, are sometimes threatened or bribed by the defendant company and may reverse their testimony when they are put on the witness stand. There may be no documents or witnesses to prove monopolistic agreements, for monopolists have learned to be careful; and where there are only a few producers it is seldom necessary to have anything in writing. Thus at every stage of the game the defendant monopolist has the advantage—in strategic position, in financial support, and in legal skill.

Finally, the punishment meted out for monopolistic activities, in the rather unusual case of conviction, is seldom severe. In criminal actions between 1890 and 1940, the average fine imposed was about $2000 per defendant (in some cases this represented perhaps a fraction of one per cent of the amount gained through monopoly activities) and the prison sentences —where any were imposed—were light. "During the life of the Sherman Act [1890–1940], less than 110 individuals altogether—an average of 2 a year—have served prison sentences. And, without a single exception, all have been trade-union officials or racketeers."[5]

Socialization of monopolies

Some thirty years or more ago there was a wave of sentiment in favor of allowing the combinations to grow as big as they pleased and creating a government agency to regulate their prices; but the general failure of the public utility commissions to regulate public utility rates successfully affords little hope of success in any over-all policy of price regulation. Socialists insist that the only remedy is socialization of the big industries. Certainly this would eliminate much of our private monopoly, and we are moving in this general direction; but whether it will end our troubles or multiply them is a question which must be left for a later chapter.[6]

International cartels[7]

Number. In many cases domestic monopolies are tied up with *international cartels*. Some forty international monopolies were recorded prior to 1896, and before the First World War there were 114. Most of them were disrupted by the war but were revived afterward; in fact, their number increased rapidly, because periods of depression and cutthroat competition tend to encourage their formation. No one knows how many there are today, but of course many of them ceased to function with the outbreak of World War II. Cartels in tin, rubber, sugar, aluminum, and quinine have been given wide publicity in recent years, and several international cartels with their American participants received dishonorable mention for following policies which impeded and delayed our war effort.[8]

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[5] Temporary National Economic Committee, *Monograph No. 16*, p. 79.

[6] See Temporary National Economic Committee, *Monographs No. 16* and *38*.

[7] Much of the information on international cartels is taken from the monograph by Corwin D. Edwards, Chairman of the Policy Board, Anti-trust Division, Department of Justice, for the Subcommittee on War Mobilization of the Committee on Military Affairs, U. S. Senate, 78th Cong., 2d sess. Some has also been taken from Theodore J. Kreps' testimony before the Temporary National Economic Committee on January 15, 1940. *Cartels: Challenge to a Free World*, by Wendell Berge, Assistant Attorney General of the United States, has been published very recently. It contains much new information on this important subject.

[8] Among the products controlled by international cartels at one time or another have been those "in such basic materials as aluminum, cement, coal and coke, copper, iron and steel, lead, rubber, sugar, tin, wheat, and zinc; in other metals and minerals, including antimony, bismuth, ferromanganese, ferrosilicon, magnesite, magnesium, mercury, titanium, and uranium; in many chemicals, including calcium carbide, cellulose, chlorine, citric acid, cobalt, dyestuffs, fertilizer, Glauber's salt, iodine, lead oxide, nitrogen, paraffin, phosphates, potash, quinine, saccharine, sulfur, sulfuric acid, and white lead; in bottles, ceramics, enameled ware, plate glass, and porcelain; in sulphite pulp, newsprint, packing, and other paper; in flax, rayon, and wool textiles, felt clothing, and linoleum; in buttons, leather, glue, oils, fats, and greases; in metal products, including ball bearings, cables, plates, rails, rivets, screws, sheets, and wires; in a variety of other fabricated products, including dental supplies, electric lamps, gas mantles, household appliances, matches, machinery, phonographs and records, railway cars, and tobacco; and in such services as transoceanic shipping, cable and radio communication, marine insurance, and the distribution of motion picture films."—Temporary National Economic Committee, *Monograph No. 21*, p. 219.

Causes of growth. Like national monopolies, international cartels are to some extent the result of technological and economic developments, particularly the increasing speed and efficiency of transportation and communication which have tended to obliterate national boundaries and to tie the world up in a single economic unit. National monopolies facing powerful international cartels in foreign trade often find it profitable, and in some case necessary, to join with them rather than compete on terms that are likely to be unequal. Particularly is this true if these cartels have government support, as they did in Germany. In some cases, as in the tin and rubber cartels, governments have encouraged monopolization. There has been a trend toward compulsory cartelization in certain European countries, particularly in Fascist Germany and Italy, and also, to some extent, in France and England, the government's purpose being to put some of its industries in a better position to meet the competition of foreign cartels. Our National Industrial Recovery Act really provided for something resembling compulsory cartelization, but the end it sought was different.

Operation. International cartels operate in somewhat the same way as national monopolies. Like the latter, these cartels often try in various ways to weaken independent enterprises: by the cutting off of raw materials, by organized boycotts among distributors, by exclusive sales contracts, by concerted refusal to grant patent licenses or permit access to technical information, by harassing litigation, by localized price wars and other guerrilla tactics. They often divide up the world market and allocate various territories to the different cartel members. American national monopolies are frequently well satisfied with this, because it means that our rich and profitable market is reserved for American members who can set their prices high without danger of encouraging imports. In some cases, although certain territories are thus allotted, others are controlled jointly or are open to all members.

Allocation of territory. As an example of the allocation of territory, we cite the agreement of the international cartel that controlled moving-picture recording and reproducing apparatus. This agreement included the principal American film producers and distributors, subsidiaries of the American Telephone and Telegraph Company and the Radio Corporation of America, three German electrical manufacturing companies, and a Dutch company. It designated the German companies as exclusive agents to make, use, sell, and lease such equipment and to license recording apparatus in Germany, Austria, Hungary, Switzerland, Czechoslovakia, the Scandinavian countries, Yugoslavia, Rumania, Bulgaria, Holland and the Dutch East Indies; and it named the American companies as exclusive agents in the United States, Canada, Australia, New Zealand, India, The Straits Settlements, and Russia.

Restriction of supply. Restriction of supply has been a common policy of international cartels, the purpose being, of course, to keep prices high. In some cases absolute limits are imposed on the amount that may be produced, sold, or exported. This has been true of the tin, steel, and nitrogen cartels, among others. In other cases, each producer is given a certain percentage of the total output; even more frequently, however, the cartel arrangement indicates what concerns are to produce each commodity. Restrictions are easily maintained through licensing the use of patents.

In still other cases, the supply has been limited through restrictions on industrial capacity, as when the cartel agreement forbids the construction of new plants. For some years the huge I. G. Farbenindustrie cartel of Germany, in combination with English and Norwegian producers, was able to delay the construction of new synthetic nitrogen plants in the United States, a serious matter in wartime because nitrogen is used in the production of certain explosives. Similarly, an agreement involving the same German cartel, the Aluminum Company of America, the Dow Chemical Company, and the American Magnesium Corporation, was able to prevent the building of magnesium plants in this country and to restrict our output of this metal to a mere 4000 tons a year. Magnesium is much lighter than aluminum, and therefore an essential in various war uses, particularly in the building of airplanes and submarines. The German concern, working in the interests of the Nazis, did not want it to be manufactured in large amounts in this country, nor did the Aluminum

Company want quantity production of a metal that would compete with aluminum. In April, 1942, the American members of this cartel were fined a total of $140,000 for participating in it, and the patents were released for use without payment of royalties.

International cartels and research. It is commonly assumed that the giant cartels, national and international, are very progressive and that their research laboratories are constantly seeking new and improved methods of production, but there is some reason to doubt this. As in the case of national monopolies, their research is apparently carried on for the purpose of fencing in the cartel's preserves quite as often as for the purpose of developing new inventions and processes.[9]

In some cartels the dominating member has tried to maintain its position by discouraging other companies from conducting research. In the electric lamp cartel, for instance, the General Electric Company, which controlled many patents, drew up licenses to other producers in such a way that they would gain no advantage from any inventions they might make. A contract drawn up in 1937 between Westinghouse Electric and Manufacturing Company and a Czechoslovakian concern included a provision forbidding the Czech company to make, use, or sell material or parts of the types or designs of manufacturers other than Westinghouse, or even to "seek the advice or endeavor to obtain manufacturing or other engineering information from such electrical manufacturers."

High prices. Again like national monopolies, cartels keep prices at high and in some cases extortionate levels. For example, tungsten-carbide, which is of great industrial importance in making hard cutting tools, was sold in the United States at $50 a pound in 1927–1928. But after General Electric and the Friedrich Krupp Aktiengesellschaft of Germany pooled their patents for its production, with General Electric controlling the price in the United States, the price rose to a maximum of $453 per pound; during the 'thirties it ranged from this down to $225 a pound. In 1940 it was still about $205 a pound, but an indictment by the Department of Justice under the anti-trust laws brought it down to between $27 and $45 a pound. A General Electric engineer stated that the cost of producing it was about $8 a pound, although other estimates put this figure as high as $25. Its exorbitant price was doubtless one reason why the United States used less than one-twentieth as much tungsten-carbide as Germany before the Second World War—a serious handicap in our war preparations. Prices of certain dental plastics were also set at exorbitant levels by a cartel of American and German producers. One such product was sold to one class of buyers for 85 cents a pound, but dentists and dental laboratories were charged $45 a pound. Atabrine, a synthetic substitute for quinine, has been sold to the government at $4.50 per thousand tablets, and a number of companies have found it profitable to produce at that price; but civilian consumers pay $12. Innumerable similar instances could be cited.

Cartels and the quality of goods. Not only are cartel prices generally high, but there is some evidence that cartelization, by eliminating competition, sometimes discourages improvements in the quality of products and in some cases actually lowers the quality. In the military explosives cartel, for instance, Nobel Industries, Ltd., an English company, was given a monopoly of certain European markets where buyers were obliged to buy Nobel products, although they preferred du Pont explosives, which were superior.

General conclusions as to the efficiency of cartels. It is difficult to draw a balanced conclusion regarding the general efficiency of international cartels, just as it is difficult to say how efficient national monopolies are. There are some economics in cartelization: elimination of certain competitive wastes such as traveling salesmen and advertising, coordination of research activities, purchase of raw materials at lower prices, and in some cases specialization of production in plants with the lowest costs. Some of these are social economies, and some accrue only to the cartels at the expense of competitors and of the concerns with which they do business. Against all such advantages must be balanced the loss of the pervasive spur of competition and the tendency toward the dead-hand routine of entrenched monopoly. Corwin Edwards comes to the general conclusion that "such evidence as is available . . . indicates that the characteristic purposes of cartels point away from efficiency and that their activities tend to diminish efficiency." One of the most frequent purposes of cartelization, according to him, is to prevent the elimination of relatively high-cost enterprises.

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[9] Corwin D. Edwards' monograph for the Senate Subcommittee on War Mobilization, pp. 32, 33.

Cartels and tariffs

The political aspects of cartels are perhaps even more important than the economic aspects. The division of world markets along territorial lines inevitably brings up problems of international relationships, particularly international trade. The territorial allocation of markets, to the extent that it restricts the market in any given country to the cartel members in that country, amounts to a prohibitive tariff on imports. To some extent cartel agreements are a *result* of high tariffs, for they would be more difficult to maintain without such tariffs; and in some cases a high tariff in one country enables its national monopolies to drive a better bargain with monopolies in other countries in setting up international agreements.

There are many illustrations of cartel control of international trade. An agreement between the E. I. du Pont de Nemours Company of the United States and the Imperial Chemical Industries, Ltd., of Great Britain practically shuts out British chemicals from the United States. The 1939 trade agreement between the United States and Canada reduced our duties on aluminum; but Aluminum, Ltd., the Canadian aluminum company, a member of the international aluminum cartel, and controlled by the same interests that control the Aluminum Company of America, continued to avoid making sales in the United States because that market was reserved to the Aluminum Company of America by agreement. The Dutch-controlled quinine monopoly required American producers to buy cinchona bark exclusively from the cartel and tried to buy up the Latin-American output to prevent independent dealers from securing it. Many similar examples could be given.

International cartels have often tried to prevent the industrial development of economically backward "colonial" areas of the world. Thus the Imperial Chemical Industries, Ltd., used its influence to prevent any important development of the soda ash industry in Brazil. Bunge and Born, an independent Argentine firm that was trying to develop the production of rayon, sulphuric acid, and carbon disulphide in Argentina, was harassed by representatives of international cartels.

Cartels and national security

According to Corwin Edwards, "Because of their international character, cartel arrangements often become convenient means by which to circumvent the legislation of national states. Avoidance of import duties and other taxes, evasion of legal control over prices, and similar activities are, of course, frequent among domestic enterprises. In international cartels, however. the aid of foreign concerns is often available to create the pretenses under which evasion takes place, and national law may often be flouted by proceeding beyond a national border to engage in unlawful negotiations or to maintain records which are inconsistent with the story being told to a particular national government."[10] The chemical cartel, for instance, evaded an agreement with the Alien Property Custodian not to return to German ownership a firm which had been seized during the First World War; and in more recent years it has evaded trading and tax laws of various countries in the western hemisphere, including the United States. The details of some of these operations are interesting but too complicated to be presented here.

Preceding and during World War II, certain practices of international cartels came to light which indicated that these organizations presented a serious threat to our national security. German members of such cartels were not independent business organizations as in the more democratic nations, but agencies of the German state itself, backed by the government and working for the political ends of the Nazis, striving to promote that nation's power and to weaken the nations which might oppose Germany's ambitions. Only a few years after the end of the First World War, the German munitions cartel began secretly to revive the country's munitions industry in violation of the Treaty of Versailles and the Treaty of Trianon; and after Hitler came into power various cartels were used in the promotion of Germany's trade interests, in Nazi political propaganda, in the collection of vital information about foreign industries, and in the suppression of strategic industries in foreign countries that might oppose Germany's expansion. The giant I. G. Farbenindustrie was the moving power in much of this work.

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[10] *Ibid.*, p. 49.

Through these cartels the Nazis were able to get information about the production of war materials in foreign countries, in some cases information that even the governments of those countries could not obtain. As a member of the Diesel motors cartel, the American Bosch Corporation sent a representative to Germany to give the Robert Bosch Company, the German concern which controlled the American company, information about the Diesel motor business in the United States and about other business as well, such as "developments in short-wave and high-frequency radio which became the basis of intertank, ground-air, and infantry radio communications in the German Army. This information, based upon experimental work in the laboratories of the United States Navy and of the Signal Corps, was acquired by American Bosch through its receipt of specifications and drawings which were made available to concerns on the approved bidding list of the American armed forces."[11] All this happened, by the way, in August, 1939, only a month before World War II broke out.

> Even more striking measures for transmission of military information were taken in the field of military optical instruments. Contracts between Bausch and Lomb Optical Co. of the United States and Carl Zeiss of Germany provided that the two companies should agree on selection of a head for the military department of Bausch and Lomb and that they should exchange manufacturing experience and grant reciprocal access to their workshops. The contracts provided that the obligation to exchange military designs should be void—"whenever the highest home Government of one party [Hitler] expressly demands that they be kept in confidence in the interest of the nation"—but this provision was immediately followed by another which bound the contracting parties to keep their agreement in strict confidence both from third parties and, so far as possible, from their own employees. The effect was, of course, that the military authorities of the United States were misled as to the character of Bausch's relation to Zeiss and therefore lacked warning of the need to make the express requirement of secrecy provided for in the contract. . . . Nevertheless, military policy resulted in certain instructions to Bausch and Lomb to keep military information confidential from all outsiders. In July 1929, an executive of the American Bausch and Lomb Co. wrote to August Lomb of Bausch and Lomb in Frankfort, Germany, enclosing a statement of military transactions for the previous 3 months, including deliveries of various articles such as range finders, periscopes, and telescopes.[12]

German cartel members, in the meantime, were careful not to transmit information to foreign cartel members. For example, in 1933 the Bavarian Motor Works was producing air-cooled aviation engines under a license from Pratt and Whitney "which provided for a royalty of $200 per engine and for semi-annual statements as to the number of each model manufactured, shipped, sold, leased, or used"; but since the royalties and statements revealed the number of engines manufactured by the German company, it insisted the next year on changing the payment from a royalty per engine to a lump sum of $50,000 to avoid revealing its rate of production. The Robert Bosch Company of Germany likewise refused to inform the Bendix Aviation Corporation, the American firm, as to its production of aviation starters, and shifted to a fixed annual royalty payment. A similar situation developed in the synthetic rubber agreement between the I. G. Farbenindustrie and the Standard Oil Company of New Jersey. The German company had developed "buna" rubber, and the American firm had developed "butyl." In 1938 Standard gave I. G. F. full technical information about the butyl, in accordance with their agreement, but I. G. F. did not turn over its patents until 1940, and it never did supply the "know how" regarding its processes. Even after the patents became available, "the full use of buna technology in the United States was delayed for about a year and a half during negotiations as to the extent to which Standard should dominate the future production of the product."[13] All during that period Standard was higgling with the rubber companies that wanted to use the process.

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[11] *Ibid.*, pp. 56, 57.
[12] *Ibid.*, p. 57.

With the outbreak of the Second World War and the rise of anti-Nazi sentiment in the United States, some American companies reduced their commitments to the German companies, but others behaved as true brothers of the Nazis. "In some cartels in which the relation of German and American partners was very close, the American company undertook to safeguard its cartel interest and serve its German partner by forestalling British measures to blockade enemy trade. If the Germans had formerly enjoyed exclusive rights in the South American market, permission was given by the German cartel members to their American partners to supply the South American customers during the emergency provided the American concerns agreed to withdraw from the field after the war. Less frequently the American partner assisted the German company in obtaining supplies for shipment to Germany or in borrowing funds abroad."[14] Even after the war began, in September, 1939, Sterling Products, Inc., an American concern, cooperated with I. G. Farbenindustrie in shipping certain products to Germany through the British blockade and in obtaining a loan in the United States.

During the war, some cartels tried to prevent the seizure of alien property by transferring property and assigning patent rights to domestic concerns, these assignments to be valid only for the duration. Thus, a few months after war was declared, the du Pont Company and I. G. Farbenindustrie shifted patents about in such a way that the governments of belligerent countries found it difficult to seize the patents under their war powers. The two companies realized that the United States might become involved in the war and that the German-owned patents would be seized by the Alien Property Custodian. Immediately after the war began, the Standard Oil Company of New Jersey and I. G. F. likewise worked out an agreement that would avoid the seizure of property and patents in the countries in which the two companies had patents; the agreement involved the transfer of some 2000 patents to Standard, in return for which patent rights outside the United States and the British and French empires were assigned to I. G. F. The facts are complicated and confusing, but the essential purpose of the transaction was to make it appear that the patents belonged to an American company and therefore could not be taken over by the government in the event of our entry into the war. In May, 1943, the Alien Property Custodian ordered Standard to surrender about 675 patents and 100 applications for patents, apparently some of those that were involved in the agreement with I. G. Farbenindustrie; some of them covered processes for refining crude oil and for making synthetic gasoline and synthetic rubber.

Other examples of this could be given, but they would only reinforce the general conclusion that international cartels know no home country, and that some of them feel less loyalty to their country than to their own members, even those who are members of enemy nations. Although some of the activities of certain American members seriously handicapped the government in its war effort and cost the lives of soldiers on the battle front, it would be unfair to charge them with treasonable motives, for business is business and profits are profits, and both have often been preferred to the lives of soldiers. In every war, some concerns have waxed rich selling the Army defective arms, spoiled meats, inferior clothing, and other worthless supplies; in every war many people —and not business corporations alone—have sought to enrich themselves while our boys were fighting, just as they did in World War II. Ours is a profit-motivated society. It is clear too that for a time American members of international cartels believed that Germany would probably win the war and were anxious to preserve friendly relations with the conquerors.[15]

As former Vice-President Wallace said: "In reality, much of our economic relationship with the rest of the world has been governed by a small group seeking to parcel out the resources and markets of the world so as to control production, prices, distribution and the very life blood of world industry. These cliques have their own international government by which they arrive at private quotas. Their emissaries are found in the foreign offices of many of the important nations of the world. They create their own system of tariffs and determine who will be given permission to produce, to buy and to sell."

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[13] *Ibid.*, pp. 58–60.

[14] *Ibid.*, p. 64.

[15] See Guenter Reimann, *Patents for Hitler.*

The control of international cartels

It may seem that we have given too much attention to international cartels, but they present one of our most important problems. Many of them are still in existence, with headquarters in Liechtenstein and Switzerland, and many of their agreements provide specifically for resumption of activities, now that the war is over. Almost more powerful than nations, they will soon be doing business at the old stand unless something is done about them.

There are various ways of attacking the problem of international cartels. In the first place, our government might try to break them up, or at any rate forbid American corporations to become members. Whether such a policy would do more good than harm is not clear, and the general failure of our efforts to break up national monopolies suggests that we would have little success with international combinations. In the second place, we might socialize our national monopolies, and in this way bring the government into any international cartels that might be established. This would enable it to protect our national interests, somewhat as the Nazi government protected German interests through its control of that country's national monopolies; but it is highly improbable that the American people will do anything so radical within the predictable future. In the third place, we might abolish the entire patent system—refuse to issue patents to Americans or to protect the patents held by foreigners—and so pull one of the main props out from under the whole structure of monopoly, national as well as international. Whether this would slow down industrial progress is a question on which experts disagree. At any rate, along with such a policy the government would have to subsidize industrial research, perhaps pay much or all of its cost. Finally, we might try to establish some form of world organization, a new League of Nations, which would assume control of international cartels, along with other international problems. Such an organization must be created if civilization is not to perish in a welter of warring nations, and it would be the logical ruler over cartels; but its creation involves great difficulties, as the San Francisco Conference clearly proved.

One step, if only a short one, on the road to cartel control has been proposed in a bill introduced in the Senate by Senator Joseph O'Mahoney. This bill, following the precedent of Norwegian law, provides that all international cartel agreements which tend to restrict trade or production must be registered with the Attorney General of the United Sates. If such a law could be enforced, it would provide much-needed publicity, but it is easy to see that it might often be evaded.

State monopolies

A few commodities have been completely or largely controlled by a single country. Chile once had practically a world monopoly in nitrates and was able to pay a large part of her government expenses from the export tariff on them; but within recent years manufactured or "synthetic" nitrates have robbed her of this monopoly. This and the German prewar potash monopoly are examples of what amounts to absolute monopoly, as are the Brit'sh nickel monopoly and the Diamond Syndicate of South Africa today. Nearly all the world's radium comes from a single mine in the Belgian Congo. Brazil produces two-thirds of the world's coffee, and her government sometimes burns part of the crop to raise prices. In 1922 the British government engineered a scheme to restrict the production of Malayan rubber, but the effect was to stimulate rubber production in the Dutch East Indies and the scheme was abandoned. While it was in operation, it cost American consumers millions of dollars—one estimate is $400,000,000.[16]

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[16] See Alfred Plummer, *International Combines in Modern Industry*, and the *Commerce Monthly*, March, 1929, pp. 3–10, 28–30.

QUESTIONS

1. "The international cartels maintain efficient research departments which bring rapid improvement in their products." Do you agree?
2. What difference does it make to the du Pont interests, affiliated with international monopolies, whether the United States has a high tariff policy or free trade?
3. Since cartels divide up the world among their various members and to some extent stop trade among nations, they should be approved by protectionists, should they not? Explain.
4. During the Second World War an effort was made to build up a chemical industry in Mexico, but the United States government opposed it, and it was dropped. What interests in this country were responsible for our government's policy? What right has our government to dictate what shall be done in Mexico?
5. Suppose our government were to start a campaign to put an end to all international monopolies. What various measures might the monopolies take to ward off such action? Would they probably succeed? What powerful forces would support them, openly or secretly?
6. If we could destroy international monopolies, we would to some extent weaken our own national monopolies. Why? And if we could wipe out our national monopolies we would have less to fear from international monopolies. Why? Would the latter nevertheless be a serious problem for us? How?
7. In what ways did international cartels impede our preparation for war?
8. The British government and British industrialists argue that international cartels are necessary to prevent "ruinous" competition in the oil, rubber, tin, and certain other industries. Is there any basis for this argument? Is competition almost always "ruinous" to some of the competitors?
9. According to Assistant Attorney General Wendell Berge, "It seems abundantly clear that America can never have a foreign policy based on the principles of democracy and international good will as long as international trade is dominated by cartels." Why is this true? Is it any worse to have our foreign trade controlled by cartels than by protectionist politicians who want to keep it at a minimum?
10. Why is it unlikely that our government will ever have much success in reducing the amount of monopoly?

Part III

PRICES

Chapter 12.

Human Wants and Utility

Capitalism, in its simple form, has been defined as "production for the use of others and acquisition for the use of self," production for the use of others being one aspect of labor specialization. Having considered some of the most important problems of production, we turn now to the second general field of economics, price and exchange. The discussion of the physical exchange of goods in domestic and foreign trade will be deferred until we have analyzed the general problem of value or price determination, value or price being defined as *the ratio at which goods exchange for each other.* This is really the central problem in economics, so definitely so that capitalism is often said to rely on the "price system" or even to *be* a "price system." In the discussion of value or price, we shall begin with the study of human wants and utility, utility being *the power that goods have to satisfy wants.*

Origin of wants

Desires or wants may arise in different ways: through biological survival, from rational calculation, from emulation, from convention and fashion, from habit, as the result of advertising and salesmanship, and from various combinations of these.

All animals have wants, mostly simple and stable. As Henry George expressed it: "There is still this difference between man and all other animals—he is the only animal whose desires increase as they are fed; the only animal that is never satisfied. The wants of every other living thing are uniform and fixed. The ox of today aspires to no more than did the ox when man first yoked him. The sea gull of the English channel, who poises himself above the swift steamer, wants no better food or lodging than the gulls who circled round as the keels of Caesar's galleys first grated on a British beach." Man's wants, on the other hand, are infinitely numerous and complex, infinitely expansive, many of them changeable, irrational, or even harmful.

1. Most of the elementary wants—for food, drink, physical comfort, and sex gratification—are *biological* in origin. They have contributed to survival. According to Fetter: "Every species of animal has desires which are built into its nervous system as the resultant of multitudes of choices made by its ancestors. Those individuals which chose things 'bad' for them were eliminated, and those which chose 'good' things survived to transmit their nervous organization to their offspring."[1] For instance, the animals that were keenly hungry and per-

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[1] Walter E. Spahr and others, *Economic Principles and Problems,* 3rd ed., vol. i, p. 460.

sistently aggressive in their search for food when they needed it grew strong, whereas others that were driven by a less imperious desire for food developed less vigor and tended to die out. It was the "survival of the fittest," the fittest being those that had wants whose satisfaction was good for them.

Man's simplest wants are similarly a matter of biological survival. It is through this process, at least in part, that the Eskimos have developed their appetite for fats, which they need in a cold climate, whereas inhabitants of the tropics want more fruit; why people generally crave meat in the fall and winter, and fruits and vegetables in the summer. Apparently individuals have even developed a capacity for wanting the particular foods that are good for them. What is charged to unreasonable fastidiousness in children is sometimes a well-founded aversion to things that are not good for them. The biological wants are generally limited to food, warmth and shelter, clothing, and reproduction.

Natural selection may take the form of sexual selection; in fact, some of man's wants have persisted because they are useful in finding mates. It is probable that women, and men too, like finery partly because those who decorated themselves attractively were able to find mates and hence left progeny in whom this trait survived. Perhaps many of our wants may be ascribed in some degree to this process.

2. Some wants above the elementary level are the result of more or less *rational calculation*. Thoughtless people sometimes assume that nearly all our wants are rational—that we deliberately and rationally ferret out our most important wants, compare products and services with full knowledge and a coldly calculating mind, and weigh with judicious care all the direct and indirect benefits that will result from the purchase of each of the available goods among which a choice must be made. Certainly such rationality does not characterize most people, yet some are fairly rational in their wants, and most people do some rational thinking about them.

It is important, in this connection, to distinguish between personal rationality and social rationality. However irrational a social custom or fashion may be, the individual may be personally rational in conforming. The corsets of an earlier day, the bustles, hoopskirts, and crinolines, the many petticoats (modest and proper women often wore at least three pleated underskirts, each seven yards around —sixty-three feet of petticoats to wash every Monday!), all these satisfied socially irrational wants. Yet, individually, the women could not be accused of being irrational in conforming, because social convention demanded it. A woman who insisted on dressing sensibly in those halcyon days would have been regarded as a frump or even a demimonde. So too the men's long silk hose and powdered wigs of colonial days; the high collars, tie pins, and assorted jewelry of only a generation ago, indeed almost all jewelry; the high-heeled shoes of recent years, the periscope hats, and almost all women's hats; dress suits and zoot suits— all these represent irrational wants, but the individual is obliged to conform and probably does so quite willingly. A dress suit is ugly and uncomfortable, and many men hate to wear one; but the "better classes" wear dress suits, and a gentleman is obliged to wear one on certain occasions. Some savage communities have very cruel customs: filing the teeth or breaking some of them off, wearing rings in the nose or ears, or plates in the lips. Since this is the custom, the individual "wants" to follow it, but of course the community would be happier if it had more rational customs. The satisfaction of socially irrational wants is a great waste. We shall return to the subject of rationality later for a more careful discussion.

3. Many of our wants arise from the spirit of *emulation*, the desire of everybody to get ahead of everyone else, to make a display of pecuniary superiority. Most people desire the esteem of others, or it may be envy that they crave. There is much truth in Mark Twain's dictum: "Man will do many things to get himself loved, he will do all things to get himself envied"; and many wants arise from the craving for the admiration or envy of others. Expensive clothes, big houses, costly furniture, cars, silverware, and jewelry are wanted partly for this reason; in fact, perhaps most of the goods bought by the middle classes and the rich are bought partly in order to arouse admiration or envy in others, or at any rate to avoid their contempt or commiseration. The

competition in recent years has been fiercer in the purchase of cars than of homes, because cars are driven everywhere and hence advertise pecuniary reputability more widely than houses, which stand in one place and can be seen only by those who pass by, many of whom do not even know whose houses they are. Fine clothes also advertise the wearer wherever he goes, and are therefore generally preferred to fine homes. Perhaps here we see why our nation is better provided with cars and clothes than with homes.

The spirit of emulation seems to be natural among men, for there is something of it in many primitive tribes. In various African tribes it takes the form of competition in the number of brass rings that can be worn, perhaps around the neck, or in the size of the brass plates that are worn in the lips, or in the elongation of the head effected by bandaging, or in obesity, the fattest women being regarded as the most beautiful. The American Indian took his emulation in eagle feathers, scalps, beads, and fast horses; and an Indian of distinction in full regalia was something of a dandy. In modern, so-called civilized societies, we want and have to have a great many things to show our reputability, to establish our real position in the race of life, and it often takes much hard-earned money to buy them.

To the extent that our wants are the result of emulation, their satisfaction is very wasteful of human energy and productive wealth. In trying to make a good showing, many people spend money that is needed for healthful living, spend for permanents and fur coats what should be spent for milk and oranges and medical services. Even worse, there is little general benefit from emulative spending, for with it all there are no more people ahead in the mad race than there would be if the race were not so fast. When the Joneses buy Venetian blinds, the Smiths do likewise, and pretty soon the whole neighborhood has Venetian blinds; and then the Joneses are no better off than they were before, unless they really like Venetian blinds. We can see this waste in the clothing bills of American families. For about $10 per person in summer and $30 in winter, men and women *could* dress as artistically and comfortably as they are accustomed to dress on three or four times as much—this would amount to a total saving of hundreds of millions annually—but they could never remain on that modest standard for long. First the rich would add some more expensive habiliment, then the near-rich would buy it, then the middle classes would buy something like it, and finally the poor would scratch gravel to get enough money to buy a Kresge imitation of it. This process would continue with one thing after another until everything again reached the status quo, with the people wasting most of their clothing money in emulation, while doing without things they really need.

H. J. Davenport points out that emulative spending impoverishes not only the spender but others as well:

> In our false standards of well-being—our improvidence in the competitions of display—we not only waste the product of our own energy by an automatic method of cancellation by averages, but in wasting our own share of product we at the same time make our neighbor's share poor and mean and insufficient. We rob ourselves and yet filch from him. Poverty, though relative, is as real as ever before, since artificial but none the less imperative needs leave as little as ever to spare for primary necessities. There is no cure for it but in rational standards of well-being. So long as by the expenditure of one in empty magnificence another is compelled in stupid fear of stupid criticism to waste the raw material of his welfare, material progress must prove a delusion, and the old doom stand unrepealed— the poor ye shall have always with you.

Davenport adds a characteristic bit of philosophy from Benjamin Franklin. "Franklin remarks that our eyes, although very useful, require nothing more than a pair of spectacles, an outlay which ought not greatly to disarrange our finances; it is the eyes of others that ruin us. If all the world were blind excepting myself, I should have need neither of fine raiment, nor of palaces, nor of extravagant furnishings."[3]

In their desire to make a good showing, many people want certain kinds of goods *partly* because they are expensive. Fur coats are not essentially beautiful, and in temperate climates they are probably no more comfortable than good woolen coats; but some women hanker for them partly because they look expensive. Leather-bound books are often bought by wealthy book connoisseurs, although leather binding is not as durable as buckram.

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[3] H. J. Davenport, *Outlines of Economic Theory*, pp. 338, 344. By permission of The Macmillan Company, publishers.

It should not be assumed, however, that most expensive goods are wanted entirely or even mainly because of their expensiveness. It may not mean much to say that expensive goods are often beautiful, for philosophers cannot define beauty, and standards of beauty vary among tribes and peoples and change from time to time, being largely conventional. Most of the ladies of an earlier generation thought fine crinolines and hoopskirts and bustles beautiful, but few would say so now. The elaborately carved furniture of the mid-Victorian period was considered beautiful at that time, but most informed people think it ugly now; and this is also true of many of the elaborate mansions of that period. On the other hand, there are a few things which for centuries have been regarded as beautiful by informed people, as for instance the Venus de Milo, Rembrandt's paintings, Chippendale furniture, and the music of Mozart; but appreciation of even some of these changes from time to time, and many of the peoples of the world would doubtless think them very poor stuff. At any rate, although expensive things usually seem beautiful to many people, we cannot explain much by saying that they are wanted because of their beauty because we cannot define beauty.

Expensive goods and commodities usually have real merit of an objective sort, however, merit which an economist can discuss safely. Gold is a wonderful metal in its softness, malleability, and freedom from rust and corrosion; diamonds are marvelously hard, brilliant, and resistant to scratching and marring, far superior to glass in most respects; many jewels have colors that cannot be matched in glass. Expensive clothes are usually well tailored and durable; expensive rugs have beautiful colors and are generally durable; expensive cars are comfortable, powerful, fast, and durable. It would be incorrect to assume that people who buy expensive clothes, oriental rugs, and Cadillac cars do so mainly because they are expensive. Indeed, if this were true, the economic world would be a madhouse. If people bought goods *only* because they were expensive, there would be no reason why producers should produce goods of merit, because they could make greater profits by merely raising the prices of shoddy goods. Under such conditions it is difficult to see how any goods could be either good or cheap.

Since expensive goods are generally rare, however, they may satisfy a more intense want than cheap and common goods, according to the principle of diminishing marginal utility, which will be explained later. For the present it is sufficient to note that cheap goods are usually common, plentiful, often seen, and therefore can scarcely arouse much enthusiasm; expensive goods are scarce, seldom seen, and therefore likely to arouse our interest; and if they are not obviously ugly or unattractive, they may well seem beautiful and desirable. There are many illustrations of this. It is doubtful whether walnut and mahogany wood are intrinsically more beautiful than hard pine, but they are more rare and therefore seem more beautiful. Queen Elizabeth was said to be very proud of the calico dress sent her from India, and if calico were as scarce now as it was in her day it would doubtless seem very fine; similarly, if silk were cheap and plentiful like cotton, its "lovely sheen" would be an "ugly shine." Mark Twain touched upon this principle when he said: "I wonder how much it would take to buy a soap-bubble, if there was only one in the world? One could buy a hatful of Kohinoors with the same money, no doubt."

4. *Convention* determines many of our wants. The Germans like sauerkraut, Limburger cheese, coffee, and beer; the English want beef, tea, and whisky; Mexicans like tamales; the French have a particular fondness for frogs' legs and wine; Americans like chewing gum, pancakes, and pie, and anything from coffee to gin to drink. Even within our own country, Southerners like corn pone and Bostonians are famed for their baked beans. Such peculiarities are of course conventional. One of the preliminary expenses of marriage is the conventional diamond ring which a young man buys for his fiancee; the fiancee often spends her savings for a trousseau. These are conven-

tions, like the wedding ring, and indeed the church wedding itself in most communities, and the wedding trip which customarily follows, with its allied convention of throwing rice and old shoes. Courtship and marriage are associated with various conventions, as are most details of the relationships between the sexes, and also social relationships in general. A book on etiquette is an encyclopedia of the accepted traditions of good society. In the styles of houses too, convention has always been important. The early New Englanders built fine, beautiful homes—the Colonial style of architecture—many of them much alike and now recognized as genuinely artistic in design. That was the convention. When the Middle West was settled, other designs of houses were built, most of them very ugly, and there has been continuous change ever since.

Fashion is convention but is usually taken to refer generally to convention in social matters, especially clothes, often with particular emphasis on rapidly changing conventions or styles. In 1751 Galiani defined fashion as "an affection of the brain, as a result of which many things become of small value, simply because they are not new." Its imperious requirements are responsible for a great many wants, and rapid changes in fashions are responsible for the demand for far more goods than would otherwise be needed. If there were no style changes in women's clothes, or if they were very slow, women of the upper classes could dress on half what they now pay and they could dress much better. Most women's clothes are not made of good material because they go out of style so quickly, which means that nearly half the labor and capital used in their production and sale is wasted. There is similar waste in men's clothes, but less of it because styles do not change so much or so fast. Changes in styles in automobiles—the addition of nickel-plated bumpers or gadgets and gimcracks, white-walled tires, a little more streamlining, or anything that will distinguish the latest model—force many social climbers to buy new cars, although their old ones may be nearly as good as new. Even in home construction, where solid durability should be the first requirement, fashions, or perhaps we might say "conventions," change so fast that many good houses are out of date while still fairly good. Perhaps they lack tiled bathrooms or the newest type of kitchen sinks or cabinets or gadgets, or have bathtubs with indecently exposed legs or last year's models of electric-light fixtures. According to H. J. Davenport:

> Fashion takes its beginning in obsequiousness—in the attempt to propitiate a superior by imitation. Flunkyism still stands for something in the case, but a stronger force is now the dominant one—the desire to assert equality by similarity. But the chase after fashion is a chase for the end of a rainbow. The desire to be inimitable, to be distinguished and peculiar in glitter, is as strong with the leaders as is the disposition of the lesser people for imitation. The latter succeed and the leaders change. Worth spends all his time in devising new styles which shall minister to the demand for inequality and set again the great mob off the scent.[8]

There is a great waste of human resources in thus producing goods which go out of style before they are worn out, a waste which is the more unfortunate because so many people have not enough for a healthful living. While some must get along without enough fruit, milk, or butter and live in unsightly and unsanitary houses, others, and to some extent the same people, must throw away half-worn garments and discard serviceable automobiles and houses because they are no longer in fashion It is sometimes argued that this is good for business because it gives employment and keeps money circulating; but this is only our hoary old antique, the make-work fallacy. There would be just as much employment and money would "circulate" just as fast if style changes were eliminated; but labor would be employed and money would circulate in the production and sale of other things. Even if there were no ill-fed and ill-housed people, there would be no merit in wasting productive energies. It would be much better for the people to take more leisure, for, as Davenport says, "The point was long since passed when more burdens were needed for the mere gain of exercise. Work also is good for us only so far as it is good for us. Enough develops us, expands us in health and strength and power of thinking. Too much is a strife for vain things to the outcome of weariness."[4]

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[8] *Ibid.*, p. 338. By permission of The Macmillan Company, publishers.

Perhaps one thing can be said in favor of fashion changes—they add somewhat to variety in life. The Easter Sunday parade of women's new clothes may not be spiritually uplifting, but it is a change, and more or less refreshing. But, on the other hand, rapid changes are generally characteristic of styles that are never really beautiful and are therefore always in need of change. In the genuinely beautiful things, there are not and need not be any style changes; for they endure without change. Most people would live richer lives if they learned to appreciate such enduring things.

Although convention and fashion still demand many absurd things, such as women's sandals in winter and men's coats in summer, our wants are generally growing more rational. In both men's and women's clothing, comfort and health are given far more attention than they once were. Instead of shirts with detached and very high collars starched stiff—the "chokers" of a generation ago—men now wear comfortable shirts with attached collars, often without that decorative hangman's noose, a tie. In jewelry the same trend is evident. Two or three generations ago a gentleman of distinction often carried a huge watch with a heavy chain that ran around his neck, an imposing but awkward sort of harness; but today the small wrist watch serves. The collar buttons and cuff links and shirt studs and tie pins are likewise largely things of the past. In house construction, the trend has similarly been toward greater rationality. The old mansions—the "women killers" of a generation or two ago, with their high ceilings and countless inconveniences—have given way to the comfortable and convenient houses of today, many of them artistically designed by architects.

5. Whereas convention refers to the customary practice of society as a whole, *habit* refers to the individual's ordinary course of conduct. As we have seen, the German liking for coffee and the English preference for tea are conventions. When an individual consistently smokes or chews tobacco, drinks whisky or coffee, chews gum, eats fast or slowly, reads the paper at the breakfast table, regularly eats a light breakfast or a heavy one, swears, goes to church, wears one color of tie, he is said to have a *habit*.

Our wants are determined by habit to a greater degree than is commonly realized. This is to some extent a denial of the significance of rationality, although a habit may be formed rationally in the first place and be maintained as a means of economizing on nervous energy. Habit may thus be a conserver of energy. A perfectly rational "economic man"—one who decides every purchase rationally—would have to be not only very wise and judicious but endowed with the vigor of ten ordinary men to stand the nervous strain of choosing his purchases. J. M. Clark quotes Cooley as to the exhausting character of choice, "so exhausting that it becomes the part of wisdom to choose to yield up our prerogative of choice, save in the things we hold most important, in other matters protecting ourselves by some sort of mechanical control—some accepted personal authority, some local custom, some professional tradition, or the like. Indeed, to know where and how to narrow the activity of the will in order to preserve its tone and vigor for its most essential functions, is a great part of knowing how to live."[5]

In so simple a matter as choosing a dinner at a cafeteria, one could spend an hour weighing the various questions presented by the menu, and even then he would likely regret some of the items on his plate. Some people prefer to eat at an ordinary restaurant because they do not like to bother with choosing all the foods for their meal; or if they eat at a cafeteria, they get the habit of eating certain foods. Many persons get the habit of buying at a certain store, of buying certain brands of soap, toothpaste, cigarettes, gasoline, coffee, baking powder, and other branded articles. The writer still uses an old Wade and Butcher straight-edge razor, not entirely because he believes it superior to safety razors or to the recently developed clipper razors, but because he does not wish to bother with the problem of learning to use a new kind of instrument. A certain accountant was in the habit of keeping careful cost records on all the furniture and household utensils he and his wife used; he knew the average cost of sitting in a chair for an hour, or of having a fire in the fireplace for the evening, or of playing the piano for any given time. Such a man could presumably furnish or manage a house with a high standard of "rationality," but he could hardly be said to live in the meantime.

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[4] *Ibid.*, p. 339.

[5] J. M. Clark, *Preface to Social Economics*, p. 119. By permission of Farrar and Rinehart, Inc., publishers.

A habit of custom may be persisted in, even though it is highly expensive and unwise. During the First World War we had to skimp on wheat bread in order that the French might eat it, for the French had a stubborn habit of eating this kind of bread and could not be persuaded to eat any other kind even in a national crisis. Most people demand white bread and polished rice as a matter of habit, although bread made from coarser flour, and unpolished rice, are just as tasty and more healthful. The highly seasoned foods eaten by the Mexicans are doubtless injurious to health and no more delectable than other available foods, but Mexicans will have their pepper.

6. Advertisers spend many millions every year trying to establish or maintain consumer habits of buying certain brands of goods, and many of them are successful in building up rather stubborn and tenacious habits. The Maxwell House Coffee habit of some American people was sold some years ago for 42 million dollars, and the Jello habit for 35 million. In some cases advertisers have been able to make household words of mere trade names: automat, bakelite, brilliantine, cellophane, celluloid, comptometer, dictaphone, ethyl, kodak, linotype, mimeograph, multigraph, vaseline, and victrola. Many people believe, for instance, that kodak is synonymous with camera.[6]

That advertising has a great influence on wants will be readily conceded. The hundreds of millions spent annually on advertising contented cows, tailor-made gasoline, cough-proof cigarettes, B.O.-destroying soap, film-removing dentrifices, and health-restoring laxatives prove that advertising does create wants. In some cases the want is already there, and advertising merely makes it more insistent, or directs it to some particular brand of product. Men have smoked tobacco since the time of Walter Raleigh, but there is no doubt that cigarette advertisements induced many women to smoke. Soap has been used for centuries, but Procter and Gamble's skillful advertising directed the demand to the only soap that is exactly 99¾ per cent pure!

In some cases, advertising has created the want. We may well adopt a somewhat critical attitude toward many of the wants thus created. It is true that advertising has directed people's attention to certain worth-while improvements in goods and has raised the tone of living in some respects; the advertising of well-tailored clothes and artistically designed houses may have made the world a somewhat more attractive place. Without conceding all the virtues urged for Life Buoy soap, Pepsodent tooth paste, and Listerine, we may concede that bathing and brushing the teeth are socially desirable habits.

On the debit side of the advertising balance sheet, many entries have to be made. In the first place, advertising is a mutually self-erasing influence, for when all producers advertise, each one's appeal is largely nullified by the appeals of all the others. In the second place, to the extent that advertising does create wants, it induces consumers to dissipate much of their incomes on things that are useless or even harmful. Soap is useful and bathing commendable, but much of the toothpaste is useless, and many of the drugs and patented medicines advertised are actually harmful. Most of the people who are persuaded to buy vitamin tablets do not need them, because a well-balanced diet provides plenty of vitamins. Thousands of people have been physically injured by using the liver pills, aspirin tablets, and various drugs advertised in the newspapers and over the radio.

In the third place, the very nature of the advertising appeal is such that it can add little to the sum of human satisfactions. The advertiser tries to lead the consumer to buy by making him dissatisfied with what he has; so the consumer, after he has bought the new stuff, is out his money, but is merely in the same state he would have been in if the advertiser had let him alone. Making a man unhappy and then making him happy again is no great social service. Certain classes of society would be happier with fewer goods and more leisure, but no powerful economic interest keeps drumming at them to stop buying baubles and take their ease. As long as there is the imperative and artificially created desire for more and more goods, men must bend to the task of making enough money to buy the goods, often when they are too busy or too tired to enjoy them.

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[6] See *The Pleasures of Publishing*, Columbia University Press, April 3, 1944.

There is little reason to assume that advertising raises the rationality of wants, for advertising is designed solely to sell goods, not to enlighten the buyer. Fact and fable are used with equal readiness. Vitamin tablets have been said by some of the more enthusiastic advertisers to bring the following important blessings: they improve eyesight, prevent hair from turning gray, relieve fatigue, increase resistance to cold germs, reduce nervousness, aid digestion, increase one's energy, and prevent anemia, earache, headache, sinus trouble, catarrh, pimples, lung, liver, and kidney infections, arthritis, rheumatism, neuritis, heart trouble, jittery nerves, irritability, insomnia, bad teeth, bad complexion, poor appetite, and general discouragement; they insure a radiant personality, an alert mind, and a youthful appearance; they were an important means of winning the war, and some of them are laxative. Perhaps we should appreciate the fine restraint shown in the avoidance of any claim that they will cure flat feet and infantile paralysis. Even without this, it is easy to see how vitamin production has become a $200,000,000 business. A hundred examples similar to this could be given. None of the cigarette producers buy any but the "costlier tobaccos." What becomes of the cheaper tobaccos is a dark secret.

A typical set of wants

As an illustration of the operation of convention, emulation, and advertising in the creation of wants, let us take the home of a fairly typical prosperous, hard-working businessman, a Babbit of the type drawn by Sinclair Lewis. He lives, let us say, in a fine home, artistically designed by an architect; but it is likely that he has little appreciation of the artistic points in the house, because he has been too busy making money to vex himself with such matters. If his house "looks like $20,000" he is content. He has a grand piano, probably out of tune, which of course he cannot play, nor could he enjoy it if someone else played it. He knows only that pianos are generally found in the homes of the successful, or perhaps his wife or daughters wanted one, so he "bought a good one," even though a bass drum or a calliope would really serve him better. On the piano are copies of the latest jazz offenses, which probably please him more than music. Very likely he has a victrola, with similar jazz records, and a radio which brings in Bing Crosby and Frank Sinatra to brighten up the home. In the bookcases, built-in in accordance with the architect's plan, are fine new books with pages uncut; and on the walls are originals, prints, etchings, and lithographs, but the owner may not know which is which. He is too busy earning the money to buy these things to learn how to enjoy them. He has to work like a slave every day to get the things that convention and fashion and social emulation and advertising demand of him; but he winds up as poverty-stricken in wants, in the capacity to enjoy and appreciate, as he is rich in goods and in opportunities for ostentation. What he needs is not the satisfaction of the wants he has, he needs a better set of wants.

The desire for goods vs. the desire for activity

The study of wants brings up a question which arises very often in economics—what kind of an animal is man? Is he a sort of glorified hog, driven to activity only by the desire for such goods and services as will satisfy his wants, or is he something much higher, with a restless desire to be active, to work and plan and strive, to create, to seek excellence, perhaps for its own sake? Do his activities arise from his wants, or do his wants arise from his activities? Is the "theory of consumption" the true basis of economics, or is our science rather a science of activities? Many of the earlier economists held to the former view and regarded man as an *economic man*, selfish, rationally and calculatingly seeking to avoid pain and gain pleasure, active mainly in the quest for the things necessary to satisfy his wants. In the early stages of man's development, there was doubtless much truth in this view; and even today there is some truth in it, if not so much as is commonly believed. All men are to some extent "economic men" in this sense, and a few are little else, concerned mainly with satisfying their elementary wants, eating, drinking, idling, making themselves as comfortable as possible. The great emphasis on physical comfort in America, the mounting sales of comfort-providing and labor-saving gadgets, indicate that the "pig trough philosophy," as Carlyle called it, is widely accepted. Perhaps the heavy liquor bills of so many people have to some extent the same significance, although there is a decreasing amount of gross drunkenness. Carver suggests that one must aim low in generalizing about human wants. Almost all men are interested in hunger and sex, most men like good food, many are interested in good clothes, a few enjoy good literature and music, and a very few are supremely interested in doing fine creative work for its own sake. According to Carver, the lower desires are more common in human beings.

Recently, however, social scientists have given greater emphasis to the theory that man is not merely a sensuous calculator of pain and pleasure, but a creative animal, "an aspiring rather than a desiring being"; that he desires to be active, and that his activities do not arise from his wants so much as his wants arise from his activities. Even Aristotle believed that "it is equally a mistake to place inactivity above action, for happiness is activity." Marshall expressed this very well several decades ago: "Speaking broadly, therefore, although it is man's wants in the earliest stages of his development that give rise to his activities, yet afterwards each new step upwards is to be regarded as the development of new activities giving rise to new wants, rather than of new wants giving rise to new activities. . . . It is not true therefore that 'the Theory of Consumption is the scientific basis of economics.' "[7]

Frank Knight is even more definite in his repudiation of the theory of consumption:

> It is common to think of the economic process as the production of goods for the satisfaction of wants. This view is deficient in two vital respects. In the first place, the economic process produces wants as well as goods to satisfy existing wants, and the amount of social energy devoted to the former and neglected phase of activity is very large and constantly growing. The second point is that the production of the indirect means of want-satisfaction is by no means altogether directed to the ultimate satisfaction of wants in any direct sense of the terms. The increase in wealth is to a large extent an end in itself as well as a means to an increase of income, and this also again to a rapidly increasing degree as the standards of life are advanced. Men work "to get rich" in a large proportion of the cases, not merely in addition to, but in place of, consuming large amounts of goods. It is a grave error to assume that in a modern industrial nation production takes place only in order to consumption. It is true to a great and ever increasing degree that consumption is sacrificed to increased production. Whatever our philosophy of human motives, we must face the fact that men *do* "raise more corn to feed more hogs, to buy more land to raise more corn to feed more hogs to buy more land," and, in business generally, produce wealth to be used in producing more and more wealth with no view to any use beyond the increase of wealth itself.[8]

Knight expands this thought even further:

> Perhaps a sufficient comment on the hedonistic theory [the theory that man merely desires satisfaction of his wants] would be to run through again the main categories of economic wants, food, clothing, shelter, amusement, etc., and simply ask the candid question as to what fraction of the ordinary man's expenditure for any of them makes him "feel better" or is expected to do so. The higher one is in the economic scale, the more successful in doing what all are trying to do, the larger is the proportion of his consumption which tends to make him less, and not more "comfortable." The authors of great imaginative literature —always indefinitely better psychologists than the psychologists so-called—have never fallen into any such palpable delusion as the belief that men either strive for happiness or expect to be made happy by their striving. The same has been true of philosophers and religious thinkers of all time, and even economists have recognized the futility of attempting to satisfy wants. It is obvious that wants multiply in at least as great a ratio as the heads of the famous hydra.[9]

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[7] Alfred Marshall, *Principles of Economics*, pp. 89, 90.

[8] Frank Knight, *Risk, Uncertainty and Profit*, pp. 318–319. By permission of Houghton Mifflin Company, publishers.

[9] Frank Knight, *The Ethics of Competition*, p. 31.

Or, as the prophet has said: "He that loveth silver shall not be satisfied with silver, nor he that loveth abundance with increase; this also is vanity."

Many of the goods of every society are wanted because they are useful in some sort of human activity. As Marshall put it: "A large part of the demand for the most highly skilled professional services and the best work of the mechanical artisan, arises from the delight that people have in the training of their own faculties, and in exercising them by aid of the most delicately adjusted and responsive implements."[10] The American people spend about half a billion dollars a year on fishing—for rods and flies and boots and boats, and for the other expenses connected with catching fish that are worth, when caught, only a fraction of this cost. Fishermen are after sport—activity—as much as fish. So we demand perfectly balanced tennis rackets; balls and bats, golf sticks, billiard cues, and guns of fine workmanship; cigar lighters, electric razors, and other gadgets. On a somewhat higher plane, we like to write with a fine pen, to work with fine tools, perhaps just for the fun of it. No doubt the demand for automobiles should be included here as an instrument for exercising our faculties effectively. It is a joy to touch the accelerator and feel the car bound forward and see the billboards fly past.

Like so many other things in life, both wants and activities are subject to the great principle of relativity, and they shade into each other. Wants shade from the mere biological desire for food up to the intellectual hunger of the literary genius who denies himself needed food in order to buy books; and activities range from the common sport of the hunter who finds his greatest joy in killing, to the creative work of a Schubert or Mozart who is driven to write imperishable masterpieces of music. The desire for the satisfaction of wants also shades into the urge for activity, and it is sometimes difficult to distinguish clearly between the two. Is a copy of Shakespeare, for instance, merely a consumers' good, or does it satisfy a desire of the mind to be active, the urge for self-improvement?

The desire for excellence

Not all the hard work in the world is done to get ahead of others, or even to keep up with others. There is in most people a desire for *excellence,* perhaps for its own sake; a desire "almost as wide in its range as the lower desire for distinction. Just as the desire for distinction graduates down from the ambition of those who may hope that their names will be in men's mouths in distant lands and in distant times, to the hope of the country lass that the new ribbon she puts on for Easter may not pass unnoticed by her neighbors; so the desire for excellence for its own sake graduates down from that of a Newton or a Stradivarius, to that of the fisherman who, even when no one is looking and he is not in a hurry, delights in handling his craft well, and in the fact that she is well built and responds promptly to his guidance."[11]

Almost all of us have this motive in some degree. The farmer loves to work with a good team and takes pride in drawing a straight furrow and in seeing his plow turn the soil smoothly; the merchant finds solid satisfaction in keeping his store neat and clean and in arranging his stock attractively; the undertaker is proud if he can turn out a "nice body"; the street sweepers, so the story goes, were critical of the one who was considered "a little weak around the lampposts." Even children at an early age may take pride in good work and in good equipment with which to do it.

Human rationality

We are now prepared to return to the question of rationality, one of the most important questions in economics, but extremely difficult to analyze clearly. Much of our traditional economics rests implicitly on the assumption that people know enough about goods, and have enough rationality in using their knowledge, to choose the things that will give them something approximating maximum satisfaction; that knowing the quality of goods, they will not buy inferior goods; and that producers will therefore be obliged to make only goods of high merit, and so the productive resources of the economy will be used to provide such goods as will afford maximum satisfaction. It will be noted that rationality in its broad sense includes not only the mental "reasoning power" needed to choose goods wisely, but full knowledge of all the qualities of goods. Can we assume that people generally have such rationality, or anything approximating it?

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[10] Alfred Marshall, *Principles of Economics,* p. 89.

[11] *Ibid.,* p. 89. By permission of The Macmillan Company, publishers.

We may begin by saying that only within narrow limits can men choose the kind of lives they lead—their aims, activities, and ideals—and therefore the goods they use. Their choice is severely circumscribed by environmental limitations. The Indian in Kansas a hundred years ago could choose to be a hunter of buffalo or starve to death; the Eskimo in Alaska has practically no choice but to be a fisherman and hunter; the son of a pioneer, a few generations ago, usually had to be a farmer, although he might become a merchant. Even today the farm boy is as a rule obliged to be a farmer. There is no law to that effect, no ethical code, no fixed custom; but the influences surrounding him early in life are such that he is likely to "choose" to be a farmer. The coal miner's son has only a narrow range of choice, with limitations fixed by his home environment, his training, and his financial circumstances; hence he is likely to choose to be a coal miner. The child in a well-to-do home has a wider range of choice, but it is narrower than he himself is likely to realize. He is likely to choose his vocation as a result of a thousand influences in his home and school, and in his social, religious, and economic life; and having chosen it, he will have wants appropriate to that work.

In choosing among different classes of wants, as in choosing his lifework and the kind of life he will lead, a man is usually bound by his heredity and environment, but mostly by his environment. Today, in the United States, he is almost compelled by environmental influences to want an automobile, just as, a generation or two ago, he would have wanted a horse. He is obliged to want as good clothes as he can afford, because he will suffer in his business and social relationships if he does not dress fairly well; and the clothes must be in the prevailing style, whether he likes it or not. However boresome and distasteful schoolwork may be to him, he will want some education; hearing little but jazz, he will want jazz; since his wife and friends play bridge he will be obliged to play bridge or suffer social ostracism; if he is reared in a religious home and community he will join the church and perhaps even teach a Sunday school class. If he is an incorrigible individualist with an iron will, he may to some extent free himself from his environmental influences, may to some extent demand the sort of things that he really enjoys; but he will look queer to his associates and will probably suffer socially and pecuniarily. Emerson was correct in his dictum, "Whoso would be a man must be a nonconformist"; but he might have added, "Whoso would be a nonconformist must not mind being thought a bit queer, and may not achieve much worldly success, unless he is very able." At any rate, nonconformists are too rare to make necessary much qualification of the conclusion that, in choosing among different classes of wants, men are largely bound by environmental influences.

If we wished to go into philosophy far enough we might come to the conclusion that men really have no choice with respect to anything in the world, no "free will" whatever; that they are entirely the product of heredity and environment, the only factors that affect human character, both of which are beyond their control; and that their choices throughout life will therefore be the result of forces beyond their control, that is, their heredity and their environment. They will indeed make choices and will believe that they are making them deliberately, rationally, and of their own free will; but the choices will be the result of the type of character that heredity and environment have given them, for they can be the result of nothing else.

In choosing among the various varieties, brands, and trade-marks of a given good, the individual faces problems of a different kind, but again knowledge and rationality are not as high as we might wish, and vary widely with different sorts of goods.

The housewife does much of the spending in most homes, and she is in a poor position to know exactly how to rate all the hundreds of brands of goods among which she must choose. She is an unspecialized buyer, so busy with the routine of housekeeping—the "darning, patching, stirring the pot, buttoning and unbuttoning, feeding and spanking man's perennial progeny"—that she has little time to test a hundred brands of canned peaches, or flour, or coffee, or soap, or sheets, or blankets, or rugs. Some things she appraises fairly well, but her information regarding many others is scanty, and she is likely to be influenced by superficial appearance, by the salesman's "line," or by the advertising she sees in the newspaper or hears over the radio. There is no reason either to believe that men are more intelligent buyers than women.

In her purchases of many foods such as meats, butter, and fresh vegetables the housewife does a fairly good job because she buys every day or so and can usually tell whether foods are fresh and palatable. Yet many housewives spend much more for food than they need to; they buy expensive meats which are little better than cheaper cuts, properly cooked; and for cereal foods, crackers, and the like, they spend two or three or even ten times as much as equally healthful foods would cost. When Kansas wheat was selling for 25 cents a bushel in 1932, certain kinds of crackers made from it were selling at 70 cents a pound—$42 a bushel for the wheat used in them! Ready-mixed flour sells at a price about three times that of the unmixed ingredients, yet it is sold in large amounts. In buying canned foods, the housewife is largely uninformed and irrational. The Temporary National Economic Committee found the same grade of canned green and wax beans selling anywhere from 13 cents to 25 cents a pound; A-grade canned pears for 11 cents a pound, C-grade for 18, and B-grade for 20; A-grade tomato juice selling for as little as 5.7 cents a pound, and C-grade for 11.8 cents. According to this committee, there was "no significant correlation between price and quality"; that is, buyers who paid high prices got little better quality than those who paid much lower prices. In other words, buyers appeared to have almost no rationality at all.

Information regarding clothing is a little more adequate, but rationality is not very high. Consumers can tell something about the quality of cloth by examining it, and they can rely to some extent on the integrity of the retailers. Those who pay high prices for shoes usually get good shoes; cheap shoes are seldom good. Here there is certainly a significant correlation between price and quality. In the purchase of home furnishings, buyers are not well informed. Furniture that looks alike to the unskilled buyer may differ widely in quality of construction. Regarding such things as vacuum cleaners, buyers appear to have almost no information at all, for a $29 cleaner was found to do better work than either of two others selling in large numbers for $60 and $80 respectively. The advertising of some articles has been completely false or misleading. Thus "German silver" has no silver in it; "Toyo Panama" and "Formosa Panama" hats were not Panama hats but were made from a rice-paper product; "Philippine mahogany" is not mahogany; "French linen" is usually not linen and does not come from France, nor are "Austrian wool" and "Saxony wool" woolen products nor do they come from Austria and Saxony; "sea lion" and "beaverette" furs covered only the lowly rabbit, not sea lions or beavers; "linenized," "linen-finished," "wool-finished," "wool-spun," and "silk-finished" have been used to describe cloth which contained no linen, wool, or silk; "waterproof," "water-repellent," "water-resistant," and "shower-proof" have been used to describe many kinds of cloth which could not keep their wearers dry. When it comes to buying such things, consumer information and rationality are generally low.[12]

Knowledge and rationality are probably lowest in the purchase of cosmetics, drugs, and medicines; and here quackery and misrepresentation reap their richest rewards. Investigation of 130 brands of soap showed little if any correlation between price and quality. A brand of bath soap selling at 20.4 cents a pound was found superior to another highly advertised soap priced at $1.97 a pound. Two lipsticks, one selling at $1.25 and the other at 10 cents, were found to be practically alike. A dollar bottle of such stuff as Listerine contains less than a penny's worth of germicide, but carloads of it are sold. Of the 50,000 or so patent medicines, only a small percentage are of any real curative value, and not a few are actually injurious, yet the people buy them.

Even when the consumer has ample opportunity to learn the merits of the different brands, he often shows little rationality, or none at all. For example, a smoker has plenty of chances to try various brands of cigarettes —in fact he probably has smoked most of them—yet he often winds up with a definite preference for one brand over others exactly like it. He may drink coffee every morning, but as likely as not he will insist on a certain brand which is inferior to others that are no more expensive.

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[12] Temporary National Economic Committee, *Hearings*, Part 8.

There is generally no knowledge or rationality at all in the purchase of one other very important good, insurance. Seldom does the buyer know anything whatever about the relative standing of various insurance companies. He buys because the salesman catches him in an unguarded moment or because the salesman is a friend, but seldom because he has studied the records of the different companies.

Whether consumers today choose among the different brands and trade-marks with more wisdom than they did a generation or two ago is doubtful. Certainly they are much wiser generally, they know much more than the consumers of earlier generations; but the difficulties of choosing are vastly greater too, for there are many more kinds of goods and more brands of every kind, and they buy a larger proportion of the goods that they use. Protective laws prohibit many kinds of adulteration that were once fairly common, the quality of many kinds of goods is higher, and consumers are less likely to choose something definitely spurious or injurious.

Thus our answer to the question of human rationality is rather long and, like many answers in economics, not very definite. Certainly many consumers are so uninformed and irrational that they buy thousands of inferior and even injurious products and so keep the producers of such goods in business, and they themselves fall definitely short of the maximum satisfaction obtainable from their purchases. If consumers had full and exact information regarding everything they buy, and if they were perfectly rational in using such information, the standard of living might be raised as much as 50 per cent, with no increase in the amount of goods produced. L. R. Walker, of Sears, Roebuck & Company, testifying before the Temporary National Economic Committee, declared his belief that the standard of living could be raised at least 25 per cent merely by providing individual buyers with the same standards and specifications that the government uses in its purchases; but this would of course be impossible, for advertisers and newspapers would oppose it.

Perfect rationality perhaps undesirable

Perfect "rationality," in the sense of purely intellectual, unemotional calculation in all the affairs of life, might not provide a really happy life. Most people must indulge in some excesses and in occasional recklessness for the sake of variety and emotional release. Some people seem to find it easy to follow an even course in their expenditures, but others like to deviate from the even tenor of life occasionally, perhaps play the miser for a while, then spend freely for a time, buy crazy luxuries occasionally, while skimping on the necessities. There is something to be said for this, on the general principle of variety. As Mark Twain once said: "I don't see why a kaleidoscope shouldn't enjoy itself as much as a telescope, nor a grindstone have as good a time as a whetstone, nor a barometer as good a time as a yardstick."[18]

Impossibility of defining happiness

We have used the word "happiness" here, and shall use it occasionally, for lack of a better word; but it has no precise meaning. The maudlin old lady at a funeral, with the tears running down her nose; the reader of a sad story; the student of Humpty Dumpty University, shouting when the home team make a touchdown; the Nazi yelling "Heil Hitler" when that matchless moron appeared at the microphone; the boy riding his new bicycle; the hunter killing game for sport; the gourmand at a good dinner; the bibber deep in his cups; the Presbyterian at church communion —all these are apparently happy but in different ways. Philosophers have never agreed on the nature of happiness, but it is clearly an emotion of many different aspects, and it is not altogether a product of rationality. Some philosophers have even asserted that it is a

[18] Mark Twain, *Letters*, vol. i, p. 356.

matter of "systematized delusions," according to which a man might be unhappy either because he has not enough delusions or because he does not have them well systematized. Mark Twain touched upon this in his wise advice: "Preserve your illusions. When they are gone you may exist, but not live." We have already seen that happiness is not connected very closely with consumer satisfactions, because the satisfaction of one want leads only to a new crop of wants; and therefore the study of economics will perhaps avail little in its pursuit.

Happiness is then impossible to define.

> But the test [applied to goods and activities] is not happiness. And by this we do not mean that it ought not to be, but the simple fact that that is not what men want. It is a stock and conclusive objection to utopias that men simply will not live in a world where everything runs smoothly and life is free from care. . . . A man who has nothing to worry about immediately busies himself in creating something, gets into some absorbing game, falls in love, prepares to conquer some enemy, or hunt lions or the North Pole or what not. We recall also the case of Faust, that the Devil himself could not invent escapades and adventures fast enough to give his soul one moment's peace. So he died, seeking and striving, and the Angel pronounced him thereby "saved." "Wer immer strebend sich bemüht, den können wir erlösen." The pleasure philosophy is a false theory of life; there abide pain, grief, and boredom: these three; and the greatest of these is boredom. The Hindus thought this question of happiness through to the end long ago, and reached the inevitable conclusion—Nirvana—just life enough to enjoy being dead.[14]

The fullness of life

Since the quest for happiness is largely vain, perhaps we should direct our attention to another ideal. Marshall says that "the fullness of life lies in the development and activity of as many and as high faculties as possible." We cannot say whether life is good or not; but if it is not good we can help ourselves liberally anyhow, while we are here, consoling ourselves with the thought that we shall be dead a long while. Because we must have such a large helping of being dead, we should be alive as much as possible while we are here, exercise as many faculties as possible. We may well enjoy family life (bachelors and spinsters miss a great deal), read, listen to the riches of music and see great works of art, decorate our walls with good prints if we cannot afford originals, see a good show occasionally, travel, fish a little if we have patience, play golf, hunt antiques, dig in the ground in the springtime —Abel started that business, and man will never get away from it—walk through dead leaves in November and through snow in the winter. Strong drink is dangerous, and we need not get "full" to have a full life, but perhaps a full life has to include a modest amount of innocent wickedness.

The development and exercise of as many and as high faculties as possible, that is the good life because it is *much* life. It is on this principle that man may be said to be higher than the oyster. Having a somewhat larger and more deeply convoluted brain, he may indeed be wiser than an oyster, but he may also be crazier than an oyster. He does, however, live a fuller life because he exercises more faculties.

The law of diminishing utility

In the consumption of goods, consumers are subject to the *law of diminishing utility*, which Marshall has stated as follows: "*The total utility of a thing to anyone (that is, the total pleasure or other benefit it yields him) increases with every increase in his stock of it, but not as fast as his stock increases.* If his stock of it increases at a uniform rate the benefit derived from it increases at a diminishing rate. In other words, the additional benefit which a person derives from a given increase of his stock of a thing, diminishes with every increase in the stock that he already has."[15] The *total utility* to him is the utility of all the units of his stock; the *marginal utility* is the utility of the last unit purchased, or, if he makes the good himself, the utility of the unit or part which he thinks it is only just worth his while to make.

Analyzing this law, we note first of all that economists measure utility only by the objective standard of what an individual will *pay* for a unit of a good, or *what labor or other*

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[14] Frank Knight, *The Ethics of Competition*, p. 32.

[15] Alfred Marshall, *Principles of Economics*, p. 93. (Italics mine.)

sacrifice he will undergo to secure it. This is subject to some error, for it is hard for anyone to judge even his own desires accurately at any given time, and they change from time to time; and equal money payments of course do not represent the same utility to men of different wealth and income. Nevertheless, this is the best way of measuring that we have. One reason why economics is probably more exact than some of the other social sciences—sociology, for example—is that economists do not try to measure human motives except by the yardstick of money prices or other equally objective sacrifices.

This is much more accurate than trying to measure desires by what people say, for most people are surprisingly careless—not to say dishonest—in what they say. A woman says she would "give anything to be able to play the piano," by which she really means she would give anything but the time and effort necessary to learn; she may say that she "just loves to read Shakespeare" but cannot find time, which probably means that she really prefers to do something else with her time; she explains her negligence in writing to her friends as due to the fact that she is so very busy that she cannot find time for it, when the real truth is that she prefers to do something else. Although most people fool themselves easily and often about such things, we may assume that they usually do the things they want to do, subject to the limitations imposed by their necessary work, and buy the things that they want, subject to the limitations set by their incomes.

The price measure of utility is of little use in comparing the utility of goods to people of unequal wealth and income. The poor newsboy and the rich man's son may pay the same price for a bicycle, but its utility to the former is of course much greater. When an individual, however, pays an equal amount for two things, it may be assumed that they have approximately equal utility to him; and in comparing groups of people of equal incomes and similar tastes, equal prices indicate equal utility with fair accuracy.

The basis of the law of diminishing utility appears to be the rather simple psychological fact that in the consumption of a given good, the more nearly satisfied a man is, the less he cares for more. We might state this, more technically: "If at a given time an individual consumes successive units of a commodity, the utility of the successive units consumed declines until a point of satiety is reached." If one eats successive slices of bread, cuts of meat, pieces of candy, or units of food generally, each successive unit satisfies a less urgent want. If the consumption takes place *at a given time,* the principle applies also to habit-forming commodities, such as tobacco, intoxicating liquor, certain foods, such as olives and avocado pears, which many people have to learn to like, and to certain goods of an artistic nature, like good music, art, and literature, which, in somewhat the same way, most people must learn to enjoy.

If we do not specify that the consumption must take place *at a given time,* some of the latter types of goods—tobacco, olives, and good music—seem to be exceptions to the rule, for if the consumption extends over a long period of time, additional units have an *increasing* and not a diminishing utility. In this case, the psychological attitude of the individual changes; he is not the same man. But if he sits down and smokes successive cigars, eats olives, or listens to Beethoven, the marginal utility declines.

Our law refers not to the individual's consumption of additional units of a good at a given time, but to *increases in the stock or supply* of the good. But with increases in his stock, he is in a position to consume more at each given time. If he has a larger supply of cigars, he can consume more every day, and the marginal utility will of course decline. In the case of habit-forming goods, however, the marginal utility may not decline much; on the contrary, it may even rise, because in the period in which the supply is consumed the individual's taste may change. He may learn to enjoy such things more. The marginal utility of a stock of 100 bottles of whisky or of a hundred records of classical music may be greater than the marginal utility of half a dozen bottles or half a dozen records.

The law of diminishing utility is to some extent responsible for the production of our almost infinite variety of goods. At dinner we do not stop eating when we have enough meat and potatoes, for other foods are offered us—

perhaps several courses, ending with a dessert sweetened to tempt a jaded appetite, or, in non-prohibition states, some kind of liquor. We have not only many kinds of food at any dinner, but a wide choice of meats, vegetables, and desserts from day to day. The menu in an expensive hotel or dining car offers many different kinds of food, partly to meet the requirements of the law of diminishing utility. In the use of clothing, similarly, we find the principle of diminishing utility operating to provide wide variety. A poor man may have to content himself with one suit of clothes, one pair of shoes, one tie; but if he gains in income he adds to his wardrobe. A woman of the well-to-do class who has only a dozen dresses is likely to complain that she has "nothing to wear." In houses, the principle leads to an increase in the number of rooms and pieces of furniture. A hard-working businessman who has little time for recreation is likely to have a "recreation room" anyhow, which he enjoys looking into once in a while because it is a change from the living room.

The law of diminishing utility was not clearly enunciated by most of the early economists. Adam Smith's famous dictum in *The Wealth of Nations* indicated that he did not understand it clearly: "The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce anything; scarce anything can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it." Now the real distinction here, which Smith failed to see, is not between value in use and value in exchange, but between total utility and marginal utility. Water may indeed be said to have greater total utility than diamonds; but since it is relatively plentiful, its *marginal unit* satisfies a relatively unimportant want, whereas the marginal unit of diamonds satisfies a very important want. Fernando Galiani, who preceded Adam Smith by a few years, grasped the principle fairly clearly: "But most men reason thus: A natural calf is nobler than a golden calf, but how much less its value is. I answer, that if a natural calf were as rare as one of gold, its price would be as much more than that of the golden calf as the utility and need of the one exceeds that of the other."[16]

Total vs. effective utility

Economists make a distinction between *total utility* and *effective utility*, total utility being *the utility of all the units of the supply*, and effective utility being *the marginal utility multiplied by the number of units*. The assumption is that since the marginal utility declines as the supply increases, the total utility is greater than the effective utility. This may be illustrated by Fig. 3. It is assumed here that the consumer has three units in his supply. If he had only one unit the marginal utility would be the area $a + d$; if he had two units, the marginal utility would be $b + e$; and with three units the marginal utility is c. It is assumed that even though the consumer has a supply of three units, the first unit has utility of $a + d$ (the same as if he had only one unit), the second unit has utility of $b + e$ (the same as if he had only two units), and the third unit has utility of c. With these assumptions, the total utility is the area $a + d + b + e + c$, and the effective utility is the area $a + b + c$. This is less than the total utility by the area $d + e$.

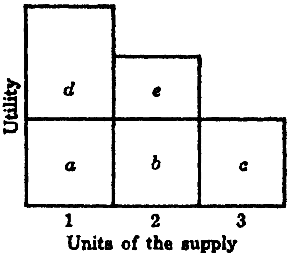

FIG. 3.

How much truth or significance there is in this analysis is difficult to determine. If we assume that a very hungry man, who for some reason has been unable to secure food, arrives at a hamburger stand, he will presumably eat hamburgers until the utility of the last one, the marginal one, just equals the price he has to pay. If the price is reasonable and he is a man of moderate income, he will get a handsome total utility from his purchase, for under the circumstances the first hamburgers have a far greater utility than that represented by price he pays. So would it be if he were extremely thirsty and came to a place where he could buy drinks, or if he had not heard music for a long while and went to a concert.

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[16] A. E. Monroe, *Early Economic Thought*, p. 287.

Such situations are not usual, however, for most people are not starving on the desert, nor are they extremely thirsty or suffering from a lack of music. Ordinarily they have easy access to food and other goods that they need, and therefore they do not develop intense desires. It might reasonably be assumed that whenever a man is hungry, whenever the utility of food rises above the cost of a dinner, he will eat; whenever the utility of a drink rises above its cost, he will drink; whenever the utility of a concert rises even slightly above its cost, he will go to hear music. The notion of a high total utility suggests that the individual is for some reason kept away from the markets where his wants can be satisfied, but as a rule this is not true. It also suggests that he develops the keen wants of a very meager economy and is then brought into an economy of plenty to satisfy them; but the poor man with the keen wants generally has to content himself with meager satisfactions, and the rich man usually does not develop keen wants.

In the consumption of certain goods, however, custom or habit prevents us from consuming individual units as our desire arises, and thus we are in a position somewhat like that of the hungry man who for a time is unable to secure food. We do not eat bits of food every hour or two; we wait until dinner and eat an entire meal. A man may not smoke at all during the working day but may smoke several cigars or cigarettes after dinner; obviously he gets a diminishing utility from successive units smoked. If we assume that the last cigar or cigarette yields a utility just equal to the price paid, we must assume that the utility of those smoked earlier was somewhat higher.

The rate at which utility declines varies both with different goods and with the kind of goods. For practically all goods consumed in the satisfaction of biological wants, the utility declines rapidly. For goods of artistic and cultural significance, on the other hand, it may decline much more slowly. A man can enjoy only a limited amount of food because the capacity of the human stomach is definitely limited; but his desire for fine clothes, for books, pictures, and music, may be almost insatiable.

Subjective value

Economists of a generation ago devoted considerable attention to *subjective value,* which we may define as *the subjective or psychological importance of a good to the individual using it.* The best analysis of the relation of marginal utility to subjective value was made by Marshall in terms of the equilibrium of the two forces, utility of the good and disutility of labor. In the case of Robinson Crusoe picking berries, there is a gradually rising curve of disutility of labor, and a declining utility of berries. It is evident that he gains a handsome consumers' surplus from the first few measures of berries, because he is hungry and for a time even enjoys his task. With each successive measure, however, the utility declines and the labor becomes more fatiguing and monotonous. At the eleventh measure the utility of the berries and the disutility of the labor are equal. From Fig. 4 it is clear that if he picked only ten measures he would miss a small consumers' surplus, and that he would pick a twelfth at a loss to him. The distance *ab* represents the marginal utility and subjective value of berries and the marginal disutility of labor.

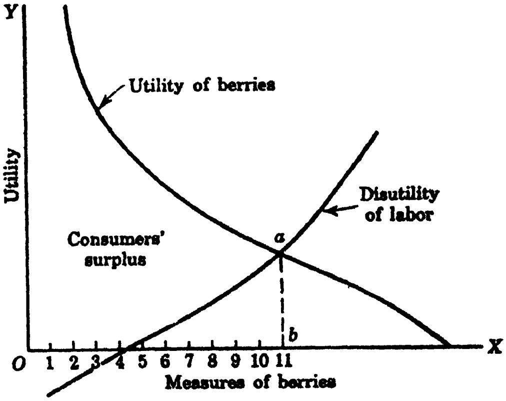

FIG. 4.

A situation analogous to that of Robinson Crusoe confronts everyone, even in the world of markets, of buying and selling. We all have a declining utility curve for goods and a rising disutility curve for the labor by which, through the medium of money, we secure goods. Some goods we must have, and the labor necessary to secure this minimum is not necessarily irksome. Almost all of us could get more goods by working harder, but at some point we decide that we want leisure and recreation more than goods; this is the equilibrium point. This point will of course vary with various individuals, depending on the slant of the two curves. If the utility of goods to a man declines slowly, if he is avaricious, he will get more than if it declines steeply. If he has great vigor and tireless energy, he will reach the equilibrium point with more goods at his disposal than if he is lazy or easily tired or if he has many other things he would like to do. Many millionaires are men of great physical vitality.

Certain peculiar kinds of goods seem scarcely to be subject to the law of diminishing utility at all for certain people. Collectors of antiques, of Indian arrowheads, of certain types of curios or historical relics, may develop a craze that is never satisfied, or, at any rate, does not decline much with additional accumulations.

Diminishing utility and children

It may seem fantastic to think of children as "goods," yet many married people balance the joy of having children against the satisfaction of buying other kinds of goods, and make some adjustment between the number of children and the amount of other goods; perhaps they decide on no children at all and abundant luxuries, or on the customary two children and a fairly generous supply of comforts and luxuries, or on a fairly large family and a modest or meager supply of ordinary consumers' goods.

As "goods," children are peculiar in several respects. In the first place, unlike most other goods, they afford greater satisfaction in realization than in anticipation. Most goods look better before they are bought than afterward; but few people realize how much children add to the richness of life until they actually have them. In the second place, the satisfaction of having children in the home does not decrease with the passing of time. They usually remain throughout life the most precious of all things, more important than all other possessions. In the third place, the law of diminishing utility does not seem to apply to added units of children, at any rate within reasonable limits. The man who valued his new baby at a million dollars but would not give two cents for another did not yet have the other one. If another came it also was probably worth a million—or perhaps slightly less if it chanced to be the twelfth or fifteenth. And finally, children as goods satisfy a very different sort of want from that satisfied by most other goods. They bring continual expense, trouble, inconvenience, and in some cases worry; but with it all, they are the most precious and satisfying "goods" in the world, a standing refutation of the hedonistic philosophy of life. Probably most well-to-do people would live finer, better, and happier lives if they had more children and fewer luxury goods. As Bertrand Russell says, "Parenthood is psychologically capable of providing the greatest and most enduring happiness that life has to offer."[17]

Diminishing utility of money income

It is sometimes said that the utility of additional units of *money*, or of money income, declines more slowly than the utility of any other individual good, and this is generally true. But the utility of money is not a simple thing, for money may be wanted for an almost infinite number of reasons because, even for the same person, it serves an almost infinite number of purposes. To most people it represents merely purchasing power, the power to command all other goods in exchange; and to the extent that this is true, the utility of money, or money income, does indeed decline much more slowly than that of any other single good. The utility of additional units of any other good, such as candy, cigarettes, ice cream, clothing, or rooms in one's home, declines sharply, because any *one* want is rather quickly satisfied; but money enables the possessor to buy a *wide variety* of goods, to turn from one of which he has about enough to others that he still wants badly, or from a cheaper to a more expensive good. Therefore the utility of money, a "derived" utility, declines much more slowly than that of any other good.

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[17] Bertrand Russell, *The Conquest of Happiness*, p. 197.

Money may, however, be wanted not as a means of buying other things but for its own sake. Some people do not spend much of the money they get, but keep it in cash or in investments. An unusual case of this is seen in the miser, the modern Silas Marner, to whom money means something to enjoy for its own sake, to fondle and pile up limitlessly. Not altogether different, but far more common, is the case of the acquisitive businessman whose life appears to be wrapped up in the process of accumulating stocks and bonds and land titles, somewhat as the miser's life is devoted to piling up ducats or shekels. The marginal utility of additional stocks and bonds and land titles does not appear to decline rapidly for him; he goes after more with unabated zest, often to the end of his life.

But the general rule appears to be that the marginal utility of increasing units of money income does decline; and this has important practical applications. It is to some extent, for instance, the basic justification for some kinds of insurance. The total loss from fire is presumably about the same, whether property is insured or not. If all property is insured, however, the loss is met from the premiums paid by all the policyholders from relatively unimportant increments of their income, increments of low marginal utility. If property is not insured, the actual money loss will be no greater, but it will be borne by a few who will lose not only their unimportant marginal units of wealth but their most important units as well—those which may mean great hardship and privation. Whether it is worth while to pay twice as much as the risk is worth, as we do in ordinary fire insurance, is a question we need not discuss here.

Regarding the *rate* at which the utility of an increasing money income declines, Marshall approvingly quotes Bernoulli's suggestion that the satisfaction a man derives from his income commences when he has enough to support life, and increases from that point "by equal amounts with every equal successive percentage that is added to his income; and *vice versa* for loss of income."[18] According to this, a man who has $100 above the amount necessary to support life will gain the same increase in satisfaction from an increase of $10 in income as from a $100 increase if his income is $1000 above subsistence.

Like many writers on economics, Marshall fails here to draw a clear distinction between the utility of an *increasing income* on the one hand, and of a *higher income in the long run* on the other hand, to a man who has grown accustomed to it. It is one thing to say that a man gains utility from a *rising* income; it is quite another to say that, once he has become completely accustomed to it, he is happier with a large income than he would have been with a smaller one. In a sense the man whose income is rising is like a hungry man who finds food. Because he has been poor, goods have a high marginal utility to him, and his larger income enables him to add these seemingly important goods. Once he has become accustomed to a greater supply of goods, however, their marginal utility declines, and the total utility rises only slowly, if at all. Marshall sees this, although not very clearly: "But after a time new riches often lose a great part of their charms. Partly this is the result of familiarity; which makes people cease to derive much pleasure from accustomed comforts and luxuries, though they suffer greater pain from their loss. Partly it is due to the fact that with increased riches there often comes either the weariness of age, or at least an increase of nervous strain; and perhaps even habits of living that lower physical vitality, and diminish the capacity for pleasure."[19]

Considering first the long-run significance of *high* average incomes as contrasted with *rising* incomes, we must concede that they probably add to happiness by raising the standards of health, cleanliness, generosity, and kindliness. Health means freedom from suffering, cleanliness has an important bearing on health, and both health and cleanliness have an influence on length of life. If we regard life as good, we shall have to say that health and cleanliness add to human happiness. Generosity and kindliness protect others from suffering and indignity and so also add to human happiness.

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[18] Alfred Marshall, *Principles of Economics*, p. 135.

[19] *Ibid.*, p. 135.

Aside from their influence in these respects, it is doubtful if *higher* incomes mean much greater satisfaction or happiness. Man is psychologically so constituted that he is capable of only a limited amount of satisfactions, only a certain level of "happiness," which he may get from few goods or from many, according to his accustomed standard of living. If he has only a few goods, they will be his "all," will command all his appreciation and give him all the satisfaction he is capable of enjoying; whereas if he has many goods, no one good can have much significance for him, and his total satisfaction will be little if any higher. Mark Twain's story of the Eskimo maiden and the fishhook shows what possibilities for wealth and happiness there are for a simple people in the possession of fishhooks, and what possibilities for unhappiness in their loss. Among some of the primitive tribes of Africa, a few brass ornaments, simple weapons, and plenty of salt are all that is needed for a happy life. Our pioneer ancestors lived simply, on an extremely small income; yet except for their relatively poor health and their lack of opportunity for cleanliness, they were probably about as happy as we are today.[20] Many men remember their vast satisfaction as boys from the fact of owning a bicycle; today a Cadillac car would hardly mean as much.

Happiness is a matter of psychology. The individual develops wants in terms of what he is familiar with, and he is satisfied and "happy" when he achieves satisfaction of those wants, no matter whether they are few or many, simple or complex. The pioneer wanted a log house, built it, and was satisfied—happy; the modern man wants a modern house with furnace and tiled bath and electric attachments and gadgets, gets it, and is satisfied—happy. The pioneer could not have wanted a tiled bathroom; he never dreamed of such a thing. He could only want the things he knew about; and he did want these and was satisfied when he got them. The man of today knows about more things, wants more things, has more things, but is no more satisfied, and little happier, than the poor pioneer.

Increase in goods production and human happiness

In the study of economics, we traditionally assume that with increases in the production of goods, more wants are satisfied and happiness increases. This is not entirely invalid, for as long as a considerable proportion of the people do not have the material basis for health, cleanliness, and some measure of beauty in life, more goods are needed. For those who have achieved these essentials, however, increased consumption of goods can add little to the richness of life. The law of diminishing utility has decreed that more goods will avail little. As Marshall says, "If . . . we spend our growing resources on increasing the complexity and intricacy of our domestic goods, we gain thereby no true benefit, no lasting happiness. The world would go much better if everyone would buy fewer and simpler things, and would take trouble in selecting them for their real beauty; being careful of course to get good value in return for his outlay, but preferring to buy a few things made well by highly paid labour rather than many made badly by low paid labour."[21]

The fundamental reason why really beautiful things increase happiness is that they afford *durable* satisfactions; indeed we might define beauty as the quality which affords enduring satisfaction. It is impossible to explain why the music of Mozart, Schubert, and Beethoven is beautiful; we can only say that their music "wears well," that the individual who listens to it does not tire of it but finds it a growing source of satisfaction, and that successive generations of men have rated it supremely good. Chippendale and Sheraton furniture, the Winged Victory, the Venus de Milo, the Parthenon, Rembrandt's paintings, Shakespeare's plays, Mark Twain's stories, Walt Whitman's poems, Thomas Hardy's novels—all these are good, "beautiful," in the sense that they "wear well," that they stand the test of time. Poor, ugly, trivial, inartistic things, on the other hand, soon pall upon us and are forgotten. Most of the goods found in ordinary homes and on the shelves of the stores, most of the things with which many people litter up their lives, are of this character. The jazz of a decade ago, the stuff found in such magazines as *Weird Tales* and *Astounding Tales* are forgotten within a short time. They are therefore not good.

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[20] The writer once spent several weeks interviewing the old settlers in a certain community in Kansas, and found them unanimous in their belief that they were as happy as people are now; in fact, most of them believed that they were happier. Perhaps they were happier in some ways, because they were more hopeful then than most people are today. His mother, one of these pioneers, still recalls the great satisfaction she got from her first mop, doubtless more than she could get now from the most expensive vacuum cleaner.

[21] Alfred Marshall, *Principles of Economics*, p. 137.

That mere increase in goods, above the level needed for health, cleanliness, and some measure of beauty, does not add much to human satisfactions appears clearly from a consideration of the exact nature of wants and the satisfaction of wants. Just what is a "want," as economists use the term? Clearly it is an unsatisfied desire which must involve a greater or lesser measure of *distress*, or else it would not lead to the effort to satisfy it. Hunger or thirst—the want of food or water—may involve terrible torture or may be only moderately distressing. Even a moderately hungry man is likely to be ill tempered; it is truly said that the only way to soothe him is to "feed the brute." Now the more intense the hunger or thirst, the greater the satisfaction of eating or drinking. The same principle applies to everything. The poor boy who longs for a bicycle, who dreams of it day and night, is definitely unhappy, unless he has a definite hope that he will get one; but if he does get one, he gains a correspondingly great joy from its possession. The pampered child of rich parents, on the other hand, who already has many toys and isn't quite certain that he wants a bicycle but thinks he probably would like it, is not very unhappy before he gets one, and not very happy afterward. The intensity of the distress of wanting tends to equal the intensity of the satisfaction of possessing. Wants which are not satisfied at all mean unallayed distress; but there can generally be no satisfaction without the preceding distress of wanting.

Allowance must be made for anticipation and hope. The boy who wants a bicycle and has strong hopes of getting it may be happy in his anticipation. Much of the pleasure of life is gained from the anticipation of satisfactions hoped for. There may be about as much satisfaction in planning a pleasure trip as in making the trip later, in saving the money with which to buy a new house as in buying it later. Much human happiness arises from hope; but when hope is gone, the distress is very real.

Inequality of incomes

Although it makes little difference whether the general level of incomes is high or low, provided that it is high enough to cover the essentials of health, it makes a great difference to the individual whether his income is higher or lower than the general level. If he is poorer than the others in his community, if about him he sees other men who enjoy luxuries that he cannot hope to have, he is likely to be dissatisfied, while if he can afford things that others cannot have, he will be satisfied, no matter what his absolute income is. In some pioneer communities a few men and women felt quite superior, and happy, because they could afford to wear shoes. Those who were able to buy the first buggies, and later the first rubber-tired buggies, found life very sweet, while those who had to drive wagons and carts found life quite sour. Perhaps one cause of the rising discontent of the masses of the people in recent years is that through the movies and other modern agencies they learn much about the luxuries enjoyed by the rich, and therefore feel their own relative poverty more keenly. They have only the distress of wanting many things, without the ability to get them.

From all this it might appear that inequality of income is a great evil, that the income of society would afford greater total utility if it were more equally divided, since any scheme which would turn income from the rich to the poor would raise its marginal utility. It might even appear that if it were possible to spur men to do their best work without allowing any inequality of income, the ideal system would be one of absolute equality; for as long as one man was richer than another the marginal utility of a part of his income could be raised by transferring it to a poorer man, or, much better although apparently impossible, by so ordering the economy that it would go to him in the first place. The conclusion cannot be stated so boldly, however, because people differ in their tastes and desires, and marginal utilities would not be equalized entirely by equalizing incomes. Some people want money —for its own sake or for what it will buy— much more intensely than others do. This is indeed one of the reasons why some people have more than others. The marginal utility of money might be as high to an avaricious rich man as to a poor man who cares little about money, although this is generally not true.

To the extent that money income is wanted for the sake of the invidious pleasure of feeling superior to people with smaller incomes, greater equality of income would presumably increase the sum total of satisfactions to some extent. The joy of feeling superior to those below us is about equal to the distress of feeling inferior to those above us; and if there were an equal number of people receiving each of the different incomes from the top to the bottom of the scale, every person except those at the very top and those at the very bottom would be below some and above others, and would have a fair balance of joy and distress. If this were the situation, equalizing incomes would take away substantially equal amounts of joy and distress, and add nothing to total happiness. But since there are very few at the top and very many at the bottom of the scale, equalizing incomes would perhaps subtract more distress than joy, and so raise total happiness.

To the extent that money income is wanted for the satisfaction of rational wants, greater equality would greatly increase the sum total of human satisfactions—the total utility of goods. Additions to the incomes of the very poor would enable them to buy things of high utility, whereas subtractions from the very high incomes of the relatively few rich would mean little to them.

Conclusions as to increasing wealth

To return now to the broad question of the relation of income to human happiness, if our general conclusion is sound—if more income, more goods, do not in the long run bring greatly increased happiness—several significant corollaries follow. In the first place, the study of economics, to the extent that it is concerned with the growth of wealth and income, throws little light on the problem of human happiness. Perhaps the philosopher can help us more. In the second place, much of the energy expended by the more advanced peoples of the world, particularly those of the United States, is wasted—the energy of businessmen, engineers, technicians and scientists, salesmen and advertisers, all those who are working to increase the production of goods. These men do increase production at a rapid and accelerating rate, but in the long run it signifies nothing. "Naught's had, all's spent, where our desire is got without content."

Yet if we can *continue to raise* the incomes of the people without generating other troubles of a serious nature, we can enjoy *increasing* income. As long as our income continues to grow, we will presumably be happier than we would be with a stationary income, unless with the latter we are able to develop a new philosophy of life to replace our present worship of physical goods and enjoyments. The Athenians of Plato's time were able to do this, and to build up what was in some respects the highest civilization ever known, on a basis of physical poverty hard to picture in the present age of plenty. These Athenians—the upper classes of free men—lived in houses without drains or stoves, slept in beds without sheets or springs, fastened their clothes without buttons, wore no underclothes or socks, warmed themselves over a pot of ashes, studied "poetry without books, geography without maps and politics without newspapers";[22] yet in their rags and hovels they produced some of the greatest literature, philosophy, painting, and sculpture of all the ages. Perhaps people could be educated to get as much satisfaction from good literature, dramatics, art, and music as they now do from manipulating gadgets and pushing the accelerator.

There are some rather ominous signs that the rise in income which has characterized the past two or three centuries may not continue indefinitely, and that a social philosophy built on it may have to be revised. The American people may soon have to learn to adjust themselves to a stationary income and to find the joy of life in something other than a growing flood of goods—for example, in the stoic or Buddhist doctrine that men should root out as many of their wants as possible rather than seek to satisfy them, or in the development of a more genuine appreciation of some of the simpler and less expensive but really higher and finer kinds of satisfactions. Certainly people could gain quite as much from the development of greater rationality and wisdom in consumption as from increases in the amount of goods. As Francis A. Walker said about three-quarters of a century ago, "It matters far less for the future greatness of a nation what is the sum of its wealth today, than what are the habits of its people in the daily consumption of that wealth; to what uses those means are devoted."[23]

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[22] A. E. Zimmern, *The Greek Commonwealth*, p. 213.

QUESTIONS

1. What do you mean by progress? By *economic* progress? Do you think you are any happier than your father or mother was at your age? What do they think about it?
2. "For the most part, man's wants can be satisfied." "The more we have the more we want." Reconcile these statements.
3. "It is not that Americans make money because they love to do so, but because there is nothing else to do; oddly enough, it is not even that the possessive instincts are especially strong with us, . . . but that we have no notion of a definite type of life for which a small income is enough, and no notion of any type of life from which work has been consciously eliminated. Never in any national sense having had leisure, as individuals we do not know what to do with it when good fortune gives it to us. Unlike a real game, we must go on playing *our* game even after we have won."[24] Do you agree?
4. According to Frank Knight, "The chief thing which the common-sense individual actually wants is not satisfactions for the wants which he has, but more, and *better* wants." By what standard would you rate some wants as better than others?
5. List the things you want and use during a day, and try to figure out the reason for each want. Which of these things would you want if you had been reared in the wilds of New Guinea?
6. Why will not the greatest total amount of satisfaction be gained when everyone spends as he pleases? Do style changes, habits, customs, conventions, and advertising reduce the amount of satisfaction gained from expenditures? Examine each case carefully.
7. What things can you think of that are wanted only because they are expensive, and not because they have really useful qualities? Do some expensive goods satisfy keen wants, not because they are expensive but because they are rarer Give illustrations.
8. If diamonds could be produced and sold for five cents a carat, would we use more of them? If aluminum were as scarce and as expensive as silver, would it to some extent displace silver for tableware? Why or why not?
9. Some savages wear brass plates in holes in their lips, or put a great many brass rings around their neck to make it as long as possible. Have Americans ever had customs as uncomfortable as these and as injurious to health?
10. The Nazis were apparently trained to love war as much as Americans love to make money. Could a dictator train American children to forget about money and turn to war with real zest? Would an American baby left with the head-hunters of Borneo assume the traits of the head-hunters?
11. Why is it important to distinguish between *personal* rationality and *social* rationality?
12. "Aside from the improvement in health and the lengthening of the life span, there is no gain from increasing wealth." Do you agree? If you do, what is the point of studying economics?

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[23] Francis A. Walker, *Political Economy, Advanced Course,* Sec. 382.

[24] Harold E. Stearns (ed.), *Civilization in the United States,* pp. 140, 141.

13. "Income in the final analysis is 'psychic' in nature and character. The unavoidable conclusion of the argument then is that the less one has of goods and services, the greater the marginal utility of those goods and, therefore, the greater the individual's 'psychic' in-income." Do you agree?
14. "The more you get, the more you want." What is the advantage of increasing the supply of goods so we can want more?
15. "The law of diminishing utility is not as 'high-hat' as it looks to the naked eye. It means something like this: You buy a thing you have wanted for a long time. The first day it looks good to you; the second day pretty fair; the third day rather weak; the fourth day absolutely punk; etc." Is this the law?
16. A tax on luxury articles that are desired merely for their expensiveness would be a nearly burdenless tax. Do you agree? Explain.
17. Would greater equality of wealth mean greater national happiness if other things were equal? Exactly why? On what ground do you justify inequality?
18. Justice Holmes once said: "I enjoy life as keenly as most people, however, I rather think. And I do despise making the most of one's time. Half of the pleasure of life consists of the opportunities one has neglected." Would Benjamin Franklin agree? Argue for Holmes' philosophy.
19. "The Americans are funny people. Knowing the joy of being comfortable, they work themselves into hardened arteries, high blood pressure, and Bright's disease devising ways of being still more comfortable, until they attain a level of bodily comfort quite as high as that of hogs in the shade of the old apple tree." Is there anything wrong about this?
20. "To create leisure and then to occupy it by killing time is a contemptible confession of failure." Can you think of any activities engaged in just to kill time? Why do people get together and then play bridge so that they will not have to talk to each other?
21. "He that increaseth knowledge increaseth sorrow"; yet education is sometimes advocated as a means of making people happy. Is there any logic in it?
22. "In the long run, accurate grading and labeling of goods would not only raise the standard of living of the great mass of consumers 25 per cent, but would raise the incomes of merchants in proportion—even of the merchants who are now selling misrepresented goods." How would this be possible?
23. Lou Maxon writes in the *Saturday Evening Post*: "Grade labeling, in my sincerest estimation, presents the greatest threat to American industry and our way of life that ever existed, because it is without question the spearhead in a drive to eliminate brands, trademarks, and eventually free enterprise." Do you agree? Why or why not?
24. "And yet one other branch lie: to wit, that I am I, and you are you; that we are units, individuals, and have natures of our own, instead of being the tail end of a tapeworm eternity of ancestors extending in linked procession back and back and back—to our source in the monkeys, with this 'so-called individuality of ours a decayed and rancid mush of inherited instincts and teachings derived, atom by atom, stench by stench, from the entire line of that sorry column, and not so much new and original matter in it as you could balance on a needle point and examine under a microscope. This makes well-nigh fantastic the suggestion that there can be such a thing as a personal, original, and responsible nature in a man, separable from that in him which is not original, and findable in such quantity as to enable the observer to say, 'This is a man, and not a procession.' "[25] Criticize. Would a modern psychologist agree?

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[25] Mark Twain, *Autobiography*, vol. ii, p. 9.

Chapter 13.

The Significance and Functions of Price

Value and price

The word value has been used in a great many different senses, but most economists emphasize mainly two kinds of value, subjective and exchange.[1] Subjective value, as we have already seen, refers to the psychological significance of a good to the individual; the exchange value of a commodity is defined as *power in exchange,* or *the power of commanding other commodities in exchange.* In the following chapters we are mainly concerned with exchange value, and when we use the word value we shall usually mean exchange value. By price is meant *the amount of money a good will exchange for.* Exchange value and price are often used synonymously, and for most purposes this involves no confusion, because the exchange values of different goods, that is, *the ratios at which they exchange,* may well be expressed by their relative prices. If a suit of clothes exchanges for twenty bushels of wheat, a price of $1 per bushel for wheat and $20 for a suit of clothes will indicate the ratio correctly. There can be no general rise or fall in values, for if the value of one commodity rises in terms of another, the value of the second must fall in terms of the first; but there may be a general rise or fall in prices, which means merely that the *value of money,* in terms of commodities, has changed. If we assume a stable price level, changes in the relative prices of different commodities will measure the changes in values. The term price will generally be used in this book, because it is most common in the business world, and therefore easier to understand.

The market defined

Prices, competitive prices, are fixed in a *market.* There are various definitions of a market, but we may define it simply as *the general area within which the forces of supply and demand meet to establish a price.*[2] The traders, the buyers and sellers, may be physically in this general area, but it is not necessary that they should be, if their demands and offers are represented in some way. In the grain and stock markets the commission men and brokers represent the buyers and sellers who are scattered over a wide area; or the commission men and brokers may themselves be considered the buyers and sellers, acting for others. At any rate, the forces of supply and demand must meet, and for identical goods they must establish identical prices. Prices tend to be identical for a product, whether the market is competitive or monopolistic. It is sometimes assumed that identity of prices asked by sellers is an indication of monopoly, and under certain circumstances it may be; but in a perfectly competitive market too, the prices tend to be identical.

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[1] For a discussion of different kinds of economic value, see Correa M. Walsh, *The Four Kinds of Economic Value.*

[2] One of the best analyses of the concept of the market is to be found in F. B. Garver and A. H. Hansen, *Principles of Economics,* 2nd ed., p. 81.

Size of markets

Markets vary widely in their scope. Certain immovable things, like houses and farms, must be supplied where they stand, and ordinarily are bought by purchasers in the immediate vicinity. The market for residences in a town or city, or for farms in a given locality, is narrow. The market for bulky, cheap, or highly perishable commodities must ordinarily be rather narrow, although its range depends on the cost and efficiency of transportation and is sometimes surprisingly wide. Common brick, building stone, and firewood are too bulky and too cheap to be transported far; yet coal is shipped across the ocean and lumber is shipped halfway around the world. Ordinarily the market for perishable commodities is limited to a narrow radius, but so efficient is modern transportation that California fruits are marketed all over the United States and in Europe, bananas from Central America are sold regularly in all parts of the United States and Canada, carloads of Florida and Georgia watermelons are sold in many parts of the United States in early summer. With our present methods of refrigeration, few fruits or vegetables are highly perishable, and the market is correspondingly extended.

To enjoy a wide market, goods should be durable, of considerable value in proportion to bulk so that they can be carried long distances, and "capable of being easily and exactly described," that is, well standardized.[3] Wheat has the first of these qualities in fair degree, and the last in high degree. Although it is not very valuable in proportion to bulk, it is durable and can be shipped all over the world at a moderate expense. Ocean rates on wheat from New York to Liverpool have been as low as five cents a bushel, far less than the railway rate from Kansas to New York. Wheat is so well standardized that a buyer anywhere in the world knows within very narrow limits what kind and grade he is buying. Thus we have what may be called a world market for wheat, although the price is considerably higher at some points than at others, owing to the cost of carriage. Changes in the price in Russia, Argentina, or Canada are promptly reflected in the price at Liverpool and Chicago. It is sometimes said that Liverpool is the "world market" for wheat, but this is not quite correct; Liverpool is only the most important of a great many related wheat markets scattered all over the world.

A better example of a world market is that for stocks and bonds and the precious metals. These possess to a supreme degree all the qualities needed for a wide market, being durable, very valuable in proportion to their bulk and therefore cheaply portable, and perfectly standardized. In every important stock market in the world, certain securities are bought and sold, such as United States bonds and the higher-grade stocks of well-known corporations; and because cable and telegraph connections are available, the prices of such securities tend to be the same at any given time. Since under trading procedures actual delivery of the securities is not necessary, the prices do not necessarily allow for cost of transportation. Gold and silver are similarly bought and sold in all the important countries, at prices which can vary only by the small cost of shipping these precious metals.

Market situations

At one time, economists assumed competition in their analysis of value, looking upon monopoly merely as an exceptional interference with normal competitive business, a sort of economic disease which appeared sporadically but was not a normal element in the economy. In recent years, however, we have come to see that monopoly is not an exceptional economic aberration but is quite as "normal," quite as persistent, as competition, and that it prevails, in varying forms and in varying degrees, in all urban industries. We have already defined monopoly as "control over the supply and price of a commodity or service." The discussion of monopoly value is reserved for a later chapter, but at this point it is well to note some of the possible market situations. With respect to the relative amounts and character of the competitive and monopolistic elements involved, market situations may be classified as follows:

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[3] Alfred Marshall, *Principles of Economics*, p. 326.

- I. Competitive
  - A. Pure competition
  - B. Perfect competition
  - C. Monopolistic competition
- II. Monopolistic
  - A. Monopolistic elements on the selling side
    - 1. Monopoly, where there is only one seller
    - 2. Duopoly, where there are two sellers
      - a. Selling identical products
      - b. Selling differentiated products
    - 3. Oligopoly, where there are several sellers
    - 4. Monopolistic competition (appears also in competitive situations)
  - B. Monopolistic elements on the buying side
    - 1. Monopsony, where there is only one buyer
    - 2. Duopsony, where there are two buyers
    - 3. Oligopsony, where there are several buyers

Competitive market situations

Some of the most important of these terms must be defined. *Pure competition* is merely competition *free from all monopoly elements,* and it prevails where the following conditions are found: (1) the product bought and sold must be standardized, identical for all sellers, so that buyers will shift from one producer to another at the slightest difference in price, (2) there must be so many buyers and sellers in the market that the purchases or sales of any one of them have no appreciable effect on the price; and (3) there must be no agreement as to price or quality among the sellers. The wheat market, on the farmer's side only, represents practically pure competition, for wheat is almost perfectly standardized, there are perhaps a million sellers, and there are no monopolistic agreements among the farmers. On the buyers' side, the wheat market is by no means purely competitive, for there may be only one or two local elevators buying wheat; this presents a picture of monopoly or duopoly —or, more precisely, monopsony or duopsony, since they represent the buyers' side of the market.

With respect to the number of buyers or sellers, competition is not sharply differentiated from monopoly but shades gradually into it. There may be a million of each, or a thousand or a dozen or only one; and as the number declines, conditions shade from practically pure competition to monopoly or monopsony. One of a million wheat producers can exert only an infinitesimal effect on the price by offering or withholding his part of the total supply; he can sell all his product at the market price, but none at even a slightly higher price. One of a thousand producers can have only the slightest influence on the price; one of a dozen has a definite effect; and a single producer can set his own price.

With respect to identity of product, it may be perfectly identical for all producers, or nearly identical, or it may differ somewhat, or it may differ greatly. Number 1 hard wheat is almost perfectly identical for all producers, although not quite perfectly identical, for there are very slight differences in samples of Number 1 hard wheat. Some other farm products are less well standardized than wheat—fruits and livestock, for instance—and in these there may be enough differentiation so that some producers will be able to command a premium price in which there is a trace of monopoly. Since there is some differentiation, some buyers will pay this price rather than turn to the most acceptable substitute. Any bushel of Number 1 hard wheat is an almost perfect substitute for another bushel, but no dairy cow or beef steer is so nearly a perfect substitute for another. To shift further from conditions of nearly perfect product identity, Kellogg's Corn Flakes are much like Post Toasties, yet different enough so that some buyers who prefer Post Toasties will not accept Corn Flakes as a perfectly satisfactory substitute and will be willing to pay a premium price, if necessary, for their favorite cereal food. The producer of Post Toasties must meet the competition of other producers of cereal foods; but since no other cereal food is a perfect substitute for his own, he can charge a price that has an element of monopoly in it. When we reach the realm of almost pure monopoly—for example, the electric company which provides current for lighting—we find gas lights and oil lamps very poor substitutes for electric lights; hence the electric company has a very strong element of monopoly power. Thus, with respect to product identity, we find every shading, from the practically perfect identity of Number 1 hard wheat to the high differentiation in lighting facilities, with resulting shading in the amount of monopoly power.

In a purely competitive market there must be no agreement among sellers as to prices or quality of product; but here again we find no definite concept, but a shading from the Christian consideration for competitors which gentlemen hold as part of their code of honor —until they see a chance to make a little profit by cutting prices—to iron-clad price agreements, with boycott penalties for violation.

Perfect competition demands all the conditions of pure competition, and some others as well. As in pure competition, the product must be standardized, there must be a large number of buyers and sellers, and there must be no monopolistic agreements on either side; but certain other requirements must also be met. In the first place, buyers and sellers must be fully informed about the commodity and about conditions of supply and demand. This characteristic is most closely approximated in the wholesale markets and in the grain and stock exchanges. Buyers and sellers in the wholesale markets are specialists who know a great deal about the commodities and about supply and demand in general, and who can therefore make their offers and bids intelligently. Retail markets are in sharp contrast in this respect, for the buyers have little expert knowledge of the goods or of the general conditions that prevail.

In perfect competition, in the second place, conditions in the market must be such that prices will respond promptly to actual or anticipated changes in supply and demand. The grain and stock exchanges fulfill this condition excellently, for here prices are almost constantly in motion, jiggling with every telegraph report or with even the slightest rumor of a change in demand or supply. A rumor that certain interests are buying or selling, that certain individuals are "bearish" or "bullish," that a certain government official favors a new business policy, that the tax policy is likely to be changed, that a new Premier has been chosen in France—any event that might affect conditions in the market may have an immediate influence on prices. In the market for houses and farms, on the other hand, prices often lag far behind changes in the conditions of supply and demand. In a period of agricultural depression like that between 1920 and 1933, the prices of farms declined much more slowly than conditions warranted, and at times were probably several years behind.

In the third place, there must be many sales, for if there are not there may not be an adjustment of demand and supply. Here again the grain and stock exchange approximate perfection, for there are hundreds or thousands of sales every day. Several million shares of stock may be sold on a busy day in the New York Stock Exchange. This means not only that there is an effective adjustment of demand to supply, but that any holder can sell promptly and any purchaser can buy at any time. In the market for farms and houses, on the other hand, the prices asked may be so far above those offered that there are no sales for a considerable time. Such a market fails to perform its primary function of fixing prices. Even when sales are made, the prices of equally desirable pieces of property may vary as much as 20 per cent in the same locality, thus failing to meet the provision that there must be *one* price, and not several.

Perfect competition requires, in the fourth place, that "there must be no friction to impede the movement of capital from industry to industry, from product to product, or from firm to firm; investment must be speedily withdrawn from unsuccessful undertakings and transferred to those that promise a profit. There must be no barrier to entrance into the market; access must be granted to all sellers and all buyers at home and abroad. Finally, there must be no obstacle to elimination from the market; bankruptcy must be permitted to destroy those who lack the strength to survive."[4]

In summary, the concept of perfect competition, as Chamberlin has well said, implies "an absence of friction in the sense of an ideal fluidity or mobility of factors such that adjustments to changing conditions which actually involve time are accomplished instantaneously in theory."[5] Needless to say, there is no such thing, but in some hypothetical reasoning it is useful to assume it, somewhat as the physicist, in some of his theoretical reasoning, assumes lack of friction.

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[4] Clair Wilcox, in Temporary National Economic Committee, *Monograph No. 21*, p. 2.

Monopolistic competition is the form of imperfect competition in which there is differentiation of products, as in competition among the producers of Post Toasties, Shredded Wheat, and Rice Crispies, for instance. Here sellers may be numerous and there is competition among them, because to some extent each product is a substitute for the others, but each seller is a monopolist with respect to his own product.

Monopolistic market situations

Of the monopolistic market situations, first on the selling side, *monopoly*, as we have seen, is control by *one* seller—any public utility, or the United Shoe Machinery Company, or the only hotel in an isolated town. All producers of differentiated products are monopolists with respect to their own particular products, but there are more or less acceptable substitutes for the products. The control of a single seller is limited, on the supply side, by the possibility that competitors may enter the field if he sets his prices too high, and, on the demand side, by the possibility that consumers may shift to other products.

The other forms and degrees of monopoly need be discussed only briefly at this point. *Duopoly*, the form in which there are two sellers, is illustrated fairly well in the production and sale of sulphur, for two companies produce 90 per cent of the sulphur sold in this country. *Oligopoly* prevails in industries in which only a few producers are credited with all or nearly all the total production, as for instance in the automobile industry. A few producers are always likely to enter into collusive price agreements, however, and in that case the situation is one of monopoly. *Monopsony*, in which there is only one buyer, is well illustrated by a smelter which is the only market for ores in a mining district, by a single linseed oil mill in a region where farmers grow flax, by a grain elevator in an isolated town in a wheat-growing district, by a sugar refinery in a beet-producing region. *Duopsony* is more common, and *oligopsony* still more common. The Big Four meat packers in the purchase of livestock, and the tobacco companies in the purchase of tobacco leaf, are examples of oligopsony. In most if not all cases, two or even half a dozen buyers are likely to enter into some agreement as to the prices they pay, and in that case duopsony or oligopsony is really monoposony.

The different forms of competition

Before proceeding further, it is well to define and analyze competition as carefully as possible. Ordinarily, competition is regarded as a form of rivalry on the part of sellers to secure the trade of buyers, or rivalry on the part of buyers to secure the business of sellers. J. M. Clark has offered some qualifications to this conception, along with a touch of wit and wisdom: "It [competition] may be defined in general as rivalry for income by the method of giving more than one's rivals give in proportion to what one asks in return, or by making the public think so, or by making them at least act as if they thought so to the extent of buying one's goods in preference to those of one's rival. Presumably the successful competitor is giving people what they want, or at least making them think he is giving them what he has made them think they want. And this is a process to which Lincoln's saying about fooling the people is peculiarly pertinent, including the part about fooling some of the people all of the time."[6]

Competition may take five different forms:

1. Pure competition, in production only
2. Competition in price
3. Competition in quality of goods
4. Competition in service
5. Competition in advertising and salesmanship

1. In *pure competition*, such as is approximated on the farmers' side of the wheat market, there is no effort to secure custom, to make

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[5] Edward Chamberlin, *The Theory of Monopolistic Competition*, 3rd ed., p. 6.

[6] J. M. Clark, *Social Control of Business*, p. 149. By permission of the University of Chicago Press.

sales. The farmers have no real problem of selling, they do not have to seek buyers for their wheat; they just dump it on the market at the prevailing price, for they can secure no more than this price by any means whatever, and at this price they can sell any amount of wheat. This is true because wheat is identical for all producers and there are so many producers that no single one of them can have any (appreciable) effect on the market price. Competition, for wheat growers, does not appear in selling, in the manipulation of price or quality or service, but in production, in keeping costs as low as possible. Paradoxical as it may seem, the common conception of competition as a contest in selling does not fit the conditions of pure competition at all. Competition in selling can occur only when competition is not pure.

2. *Competition in price* is characteristic of markets which are effectively competitive but not purely competitive. There is of course an element of price competition in all business, because even a monopolist faces the fact that higher prices mean reduced sales. There is much of it in most retail business, but particularly in the grocery business. Cut-rate drug chains often fight for business by cutting prices on certain well-known branded goods, and they also frequently advertise "slaughter prices" on their own differentiated brands. Price competition is likely to be particularly common in the sale of goods to people of small means—in the Woolworth and Kress stores, and in mail-order houses. The mail-order houses make a great point of their low prices, and do not appeal much to customers who want the highest quality of merchandise, although the quality of some of their goods is surprisingly good for the price. The stores of pioneer times emphasized low prices much more strongly than most retail stores of today, because their customers were poor and there was less differentiation in quality than there is today. In recent years, with the great increase in the use of brands and trade-marks and the growth of advertising, price competition has declined relatively, and price cutting is not regarded with favor. Producers have turned from price competition to advertising.

3. *Competition in quality of goods* is likely to prevail wherever there is any competition at all, unless the goods are of such a character that buyers are entirely uninformed and irrational in their choices. In buying most things people show some rationality, and therefore the producer must pay some attention to quality. Quality competition is most in evidence in the sale of goods to customers whose financial circumstances permit them to think much about the quality of what they buy. Exclusive shops emphasize it a great deal.

4. *Competition in the quality of the service* rendered in connection with the sale of goods is important in some kinds of business. Many grocers do not try to meet the prices of the big chain stores but instead offer credit accommodations and free delivery of goods. Competition may appear in the promptness, efficiency, training, and courtesy of the salespeople. Shops that draw their custom from the well-to-do and rich usually have a relatively large sales force, so that customers can be waited on promptly; their salespeople are efficient, know something about the goods they are selling, and treat the customers with courtesy. In stores that emphasize low prices, on the other hand, the sales force is often so small that customers cannot get prompt attention, and the salespeople are untrained and sometimes lacking in courtesy. The mail-order houses usually sell at low prices, but their mail service is in many respects inferior to that offered by local stores. Some customers demand good service and will pay high prices to get it; others are more interested in low prices and will overlook poor service if goods are cheap; but there are many who consider both prices and service, and the shopkeeper who secures their trade must satisfy them with respect to both. Where competition is not mainly in prices, as in exclusive shops, it is likely to be keen with regard to service and may result in the development of high and even extravagant standards. Marshall Field, who is said to have been one of the first great merchants to see the importance of service in merchandizing, offered an extremely high grade of service to the public, sending furniture to the homes of prospective buyers so that they could see how it looked, and even sending women's clothing out to be tried on at home. It is said that some women thus got the use of fine dresses for special occasions without cost; but the service seems to have been worth

its high cost, for Marshall Field prospered. John Wanamaker at one time provided symphony concerts and other fine music for his customers.

Another element in service may be the opportunity to choose from a large and varied assortment of goods. A retailer who is frequently out of something that his customers want will inevitably lose business unless he offers low prices as a compensation for his poor service; on the other hand a retailer who has a complete stock may be able to charge a little more for his goods than competitors with smaller stocks.

Competition in service need not be considered a distinct form of competition. Chamberlin regards service as one element in the *product*, as truly as the quality of the product itself. For example, he considers Ivory Soap sold by different stores that provide different services as really *different products*. There is certainly some logic in this, but for some purposes it may be worth while to distinguish the quality of the product from the quality of the service that goes with it.

5. *Competition in advertising and salesmanship* differs in important essentials from competition in price, quality of goods, or quality of service. With respect to the latter three, we have been assuming that the consumer *actively demands* low prices, high quality of goods, or good service. He *wants* them and he goes where all or some of them are available. He does not, in this sense, *want* the insurance agent or automobile salesman to ring his door bell, and he may rail at the advertising in the newspaper and over the radio. Yet his response to advertising is the same as his response to low prices or high quality—he buys the advertised goods, just as he buys the goods that are cheap or of high quality; or perhaps we might say that he *is sold* the goods, rather than that he *buys* them, for his role is more passive. Looking at the question from the other end, we may say that if the seller offers low prices, good quality, or good service, he is *working on the product*, trying to give the customer more for his money; whereas if, instead of doing this, he resorts to advertising and salesmanship, he is *working on the customer*, trying to get his business without offering more for his money. Since almost every producer is to some extent engaged in this general line of activity, the customer is "worked on" quite a bit, and prices and quality may receive relatively little attention.

Competition in advertising and salesmanship represents a great social waste, for it can operate only to the extent that consumers are ignorant and irrational, or, perhaps, to the extent that they are weak willed and unable to stand the pressure of the advertisers and salesmen. If all consumers were perfectly informed, rational, and strong willed, it would be useless to work on them, and there would be no advertising or salesmanship.

The difficulties facing a monopolistic combination of a large number of producers appear clearly from a consideration of the various forms which competition may take. Railroads are not allowed to compete in rates, but there is competition in the services offered by railroads running between any two points, particularly in passenger service, in speed, and in the appointments of passenger trains. In the marketing of oil products there is little competition in prices and the quality of gasoline is well standardized; but competition appears in the service offered with the gasoline and oil, often a rather expensive service. The lumber dealers in some cities have gentlemen's agreements as to prices; and since most lumber products are well standardized, it might seem that the dealers should have competition under control; but they may still compete more or less in service, many of them gladly sending up a quarter's worth of nails on ten minutes' notice. The existence of monopoly agreements may sometimes be detected by the extravagance of the service offered. Or an airtight monopoly may try to keep its customers satisfied with high prices by offering some service soporific. The telephone girls say "Thank you" when the subscriber calls a number; and this fine little courtesy, if not the most logical answer to a request for a connection casts a ray of sunshine over life's rough way and costs the company less than cheaper rates or more convenient telephones.

Functions of the price system under competition: guiding production

To the extent that a capitalist system is competitive, prices—relative prices—regulate the production of goods, the consumption of goods, the flow of income to the various classes and individuals in society; and in some measure they even determine many of our aesthetic ideals. So definitely are these the functions of relative prices that the capitalist system is sometimes spoken of as a "price system."

In competitive production, businessmen are usually quick to see a chance for profit, and if the price of a commodity rises, relative to its cost, businessmen already in the industry will be induced to increase production, outsiders will be enticed to enter the now profitable industry, and production will be increased. If, on the other hand, the price of a commodity declines, other prices remaining the same and the cost of the particular commodity remaining unchanged, there will be a tendency for producers to reduce their output, or even for some of them to leave the industry. In this way, through the action of the price system, a scarcity or an oversupply of a commodity, perhaps the result of a change in public demand, tends to be made good. If consumers bid up the price of a commodity, the price system tends to bring the increased supply needed to satisfy the demand; and if consumers turn from a given good, want less of it, the price system tends to reduce the supply to the changed level of demand.

The economic world affords us thousands of illustrations of this. When all the New Deal agencies were created, there was a serious scarcity of houses and apartments and hotels in Washington, and rents and prices of such property rose very high, with the result that thousands of houses and apartments were built within a few years. In some of the dead and dying mining towns of the West, on the other hand, there have been too many houses, rents and prices have been low, and little or no building has been done for many years. In time, a long time in this case, the slow decay of houses and the failure to build new ones bring the supply down to the needs of the smaller population.

In the production of food products, there have been many illustrations of this principle. At one time a great many Ben Davis apples were produced, but they sold at a low price because the public did not warm to Ben Davis apples; the result is that they are seldom seen in the markets today. Stark's Delicious apples, on the other hand, were very scarce and expensive only a decade or two ago, with the result that many orchards were planted, and today Delicious apples are plentiful and no more expensive than most other varieties. During the First World War and for a short time afterward, there was a heavy demand for fats, and the "lard type" of hogs was seen on most farms in the corn belt. In the next few years a change in public tastes led to a decline in the price of lard and to a higher price for bacon, with the result that the leaner "bacon type" of hogs have to some extent displaced the lard type. The high price of avocados has led to the planting of many avocado groves in California.

To the extent that there is vigorous competition, the price system tends to keep wages, interest rates, and profits about equal in all industries by attracting labor, capital, and entrepreneurs from the regions and industries where they earn little to those where they earn more. During its period of rapid growth, the automobile industry paid higher wages than most other industries because it had to attract labor from other industries; but today this differential has declined. When automobiles were slowly displacing horses, the wages of blacksmiths declined and those of automobile mechanics were high; but today this difference has largely disappeared. Low wages induced some blacksmiths to shift into automobile repair work; others, the older men, died or retired, and few young men entered the business, while many young men turned to automobile mechanics. Interest rates and profits were likewise higher in the automobile industry, but this industry attracted enough capital and entrepreneurs to equalize interest rates and profits again.

The price system tends to bring wages, interest rates, and profits to approximate equality, not only in different industries but in different parts of the country. There are some differences in wages, it is true—rather persistent ones—in various parts of the country, because labor is highly immobile. Wages have long been considerably lower in the South than in the North. At one time they were higher in the West than in the eastern part of the country, but migration to the West has largely eliminated this difference. Since "free" capital is more mobile than labor, interest rates have been more generally equalized than wages.

It is obvious that this migration of labor, capital, and entrepreneurs to regions and industries where they receive more is a public gain. It means that these factors become more productive, and that society is enabled to satisfy more urgent wants. If a worker moves from a southern state where he has been earning two dollars a day to a western state where he can earn twice as much, he increases the value of his services to society, and this is a public as well as a personal gain. He is, of course, mainly interested in his own advantage, but under the price system he is induced to do well for society.

To the extent that there is competition, the price system is thus *an automatic device for inducing producers to produce the things that people want most,* automatic in the sense that it works without any direction or interference on the part of the government and without any attention from the public. Consumers want more Delicious apples; they bid up the price, and the producers presently have more Delicious apples for them. There is no agitation over the matter, no resolutions or campaigns or acts of Congress, only the silent and automatic operation of the price system. This means great economy of human effort and attention. It means, too, that society's productive machinery and labor are devoted to the production of those things that consumers want most, those things that presumably give the greatest satisfaction—Delicious apples instead of Ben Davis, bacon instead of lard.

This principle operates only within the limits set by cost of production. Where nature limits the supply of anything closely or where cost of production is high, a product cannot be cheap and plentiful. Nature limits the supply of some things severely—radium, platinum, gold, silver, diamonds, and certain other jewels—and the high cost of large grand pianos sets a limit to their production; yet in all cases high prices tend to stimulate production and to make goods more plentiful than they would otherwise be. A high price for gold always tends strongly to stimulate gold mining. Similarly, nature sets limits to the supply of certain human talents. Only a limited number of great musicians, actors, actresses, lawyers, surgeons, and businessmen are born, and of those who are born only a small proportion develop their talents fully; but the high prices paid for such talents tend to induce those who have them to develop them fully, and so tends to make them more plentiful.

It is unfortunately true that people often want things that are not good for them, and that under the price system they get them. Considerable amounts of capital and labor are devoted to the production and sale of whisky, opium, cigarettes, patent medicines, and salacious books and magazines, which many be injurious; but under a democratic organization this cannot well be avoided. Even a dictator has plenty of trouble when he interferes with the favorite vices of his subjects.

It is unfortunately true, also, that the price system does not provide adequate amounts of some goods and services. If the people who use public parks or museums or hospitals or schools had to pay all the cost of maintaining them, public health and education would suffer. Sick people are a heavy burden on the public, so the government provides hospital service for some who cannot afford to pay for them; uneducated people are a dangerous element in any democratic society, so the government usually provides an education free or much below cost. If every man had to pay for his own police protection, many people would be at the mercy of thugs and bandits and an intolerable condition of anarchy would develop; so all governments provide police protection. An increasing number of goods and services are being taken out of the realm of the price system and are being provided by the government.

The price system and the entrepreneur

If we look at the operations of individual producers in competitive industries, we find the price system at work, impelling producers to make the most efficient use of the various factors of production—skimping on the scarce factors, using the plentiful factors more lavishly, striving always to keep costs as low as possible. The manner in which this is done may be observed in farming. In the United States, where land and capital are cheap and labor expensive, farmers use much land, much capital, and little labor; while in Belgium, where land is very scarce and expensive, and capital and labor are cheap, farmers use little land, much capital per acre, and much labor. In both countries the farmers are combining the factors in such a way as to produce as cheaply as possible. In urban industries too, entrepreneurs use relatively less labor in the United States than in Belgium or perhaps anywhere else in the world, because American labor is expensive. A German steel operator who was visiting a Pittsburgh steel mill asked where the laborers were and found it hard to understand how so few workmen could turn out so much steel; but the Pittsburgh operator was merely economizing on scarce and expensive labor.

In the use of urban land, the price system calls for the intensive utilization of scarce and expensive land and a more generous use of the more abundant and cheaper land, labor and capital being mobile and equally expensive in every part of any city. Along Wall Street in New York City, where the land is extremely scarce and expensive, little land is used with much capital and labor—that is, nearly all the buildings are high—whereas in small towns where there is an abundance of cheap building sites, all the buildings are low. It is fortunate, too, that the scarce sites on Wall Street are expensive, because that leads to their intensive utilization, makes it possible for many people to avail themselves of the various services available in this financial section, and keeps out all but the most important kinds of business. It is well that these scarce and expensive sites are devoted to banking, foreign exchange, and the more important financial business, rather than to grocery stores, hamburger stands, and service stations.

The price system and the allocation of consumers' goods

Relative prices also determine the direction of consumers' expenditures. If a product is scarce, relative to the demand, its price rises, consumption is reduced, and, to the extent that buyers have equal purchasing power, the scarce supply is reserved for those whose wants are keenest. When hogs are scarce and the price of pork is high, relative to that of beef, some pork consumers shift to the relatively plentiful and cheap beef, thus reserving the scarce pork for those who have the strongest preference for it. And conversely, if a product is very plentiful, relative to the demand, the price will be low and consumption will be encouraged. This is a very fortunate circumstance, indeed; just how fortunate will be evident if we try to imagine what would happen if it were not true. Suppose that a scarcity of pork led to *lower* prices. Increased consumption would presently eliminate pork from the market. Or suppose that a scarcity of pork led to higher prices, but that higher prices brought increased consumption. No pork, again. Or suppose that a great plenty of beef led to higher prices and reduced consumption. What would be done with all the beef?

It is therefore fortunate that scarce goods tend to be high in price, and plentiful goods cheap. This is true of all kinds of services as well. It is fortunate, for instance, that highly skilled surgeons command high incomes, not only because these high incomes encourage young men to work hard to achieve competence, but because high fees tend to restrict this scarce talent to critical surgical cases. If every trivial ailment were brought to such men, they would be worn out and unable to attend the critical cases to which their strength should be devoted.

It is often said that the price system, by turning productive energies to the most important tasks and by distributing goods to consumers according to the keenness of their wants, provides the maximum amount of goods and the maximum satisfaction from those goods; but this is true only with important qualifications, the first of which arises from inequality of incomes. The price system distributes goods to those whose wants are keenest only to the extent that there is substantial equality of incomes. Where there is great inequality, the rich may satisfy their most trivial whims, while the poor lack not only decent houses but perhaps even healthful and sufficient food. As Clay points out, the price system may regard the rich man's Pekingese puppy as more important than the poor man's education. "By following market values, producers supply the extravagant futilities of Palm Beach, while food, decent housing and clothing are lacking in the slums."[7] In this way the rich appropriate to themselves scarce and precious resources and the finest products of industry, while the poor have little that is beautiful in their homes or in their lives, however much they might enjoy such things, because they are not able to pay the market price for them. Thousands of poor people actually die every year because they cannot pay for the medical and hospital services, the rest, food, and recreation that would save their lives; whereas the rich have not only all the medical attention they need, but sometimes food and recreation to their own physical and spiritual detriment. The income of society would provide greater total utility if it were more equally divided.

Yet inequality of income is itself to some extent a result of the operation of the price system. Some of the great fortunes and large incomes are the reward for services which society rates at a high figure. Henry Ford became wealthy because millions of people bought his cars; Gary Cooper earns nearly half a million a year because people swarm to the theaters to see his pictures, because they "value" his performances highly. If we are to maintain the price system we must permit it to operate, perhaps with limitations through heavy income taxes, in determining incomes as well as in fixing the prices of goods.

The price system may fail to provide the greatest total satisfaction for a second reason. In the realm of the artistic, the market may establish high prices for contributions of no genuine merit, of only transitory value, and low prices for imperishable works of art. Milton's *Paradise Lost* sold for less than $100, many of Schubert's songs brought him only a few dollars, and Mozart's outpouring of immortal melodies earned him only a miserable living; whereas many writers of dime novels, true confessions, and jazz hits make handsome incomes. Only a few are able to appreciate great literature or art, but many have the cultural resources necessary to appreciate jazz and spicy stories. If it were possible to call in all *future* generations, however, the market would appraise things differently, for the fine things endure and are enjoyed by many generations, while the inferior stuff is soon seen to be inferior and is forgotten. If the millions who have delighted in Schubert's "Serenade" during the past century could all have bid on that song, it might have made Franz Schubert a millionaire. A modest royalty on Shakespeare's plays during the past would have netted even more than *Abie's Irish Rose* has panned out to the present date.

In the preceding chapter we considered other reasons why consumers do not secure anything approximating the maximum utility from their purchase and use of goods: emulation in consumption; the dominance of convention, fashion, habit, advertising, and salesmanship in wants; and public ignorance and irrationality. These call for no further discussion here.

The price system and future goods

To the extent that the future can be predicted, the price system also adjusts consumption between present and future to secure maximum satisfaction. Most animals live through constant successions of feast and famine, of glut and hunger. Many primitive tribes do little better, feasting without restraint after the harvest although they face the probability of famine before the next harvest is gathered. With some highly perishable products, civilized man can do little better. Watermelons and muskmelons must be eaten when they are ripe, for there is no way of keeping them long; but more durable products such as wheat and corn may be consumed immediately after harvest or saved for later consumption; and through the mechanism of the price system, the consumption of such products is spread evenly over the time between harvests. The relative amounts sold for immediate use and saved for the future depend on the judgment of grain speculators as to relative present and future prices. If speculators believe that there is likely to be a scarcity in the future and that prices will be high, they buy up wheat and hold it in storage, thus raising the present price, encouraging farmers to plant wheat, reducing consumption, and so enlarging the future supply and reducing the future price. If speculators believe that future supplies are likely to be heavy, they will buy little for storage or even sell some now in storage, thus reducing the present price, discouraging planting, encouraging consumption, and in this way reducing the future supply and raising the future price. To the extent that they are correct in their anticipations, they tend to maintain prices and consumption at a uniform level, and so prevent the feasts and famines that would otherwise follow each other.

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[7] H. C. Clay, *Economics for the General Reader*, p. 385.

Prices and individual expenditures

In the apportionment of his personal expenditures among various consumers' goods also, the individual is guided by relative prices. He weighs with more or less care the utility of each good against that of other goods costing the same amount of money; or, to be more precise, he weighs the utility of an *additional unit* of some goods against the utility of additional units of other goods that he might buy with the money, trying to get the largest total utility from his expenditures. It is sometimes said that he weighs the utility of the additional unit of each good against the utility of the *money* it would cost; but this is not strictly correct, for, as we have already seen, money has no direct utility except to the miser. Any significant change in the relative prices of various goods will bring a shift in his purchases. A rise in the price of beef, for instance, may cause him to buy less beef and more pork; a drop in the price of mutton is likely to cause him to buy more mutton and less of other meats; if oranges fall in price, he may buy more oranges and fewer apples. Or when the price of any given commodity rises, he may shift his purchases, to some extent, to almost any other commodity; but to the extent that he spends with discrimination, he will always be guided by relative prices.

Prices and the distribution of income

Relative prices determine to some extent the flow of income to the various economic classes and individuals. The relatively low prices of farm products before the Second World War meant that farmers' incomes were low and that the real incomes of urban dwellers—the incomes in terms of the *goods* that their money incomes would buy—were relatively high, for town and city people could buy generous supplies of the cheap meat, eggs, and milk produced by farmers. During World War II, this situation was to some extent reversed. Relative prices also determine the relative incomes of individuals. The farmer who produces mutton when mutton prices are high will receive a relatively high income. For salaried men and women and those who work for wages, we should perhaps say that relative prices *are* the incomes of the various individuals. Salaries and wages *are* prices, the prices paid for services. Lana Turner earns a high income; that is the price of her services; and the day laborer earns a small wage; that is the price of his services.

Prices and aesthetic ideals

Not only does the price system guide production, consumption, and the distribution of income. It is the basis of many of our aesthetic ideals. Many of our ideas as to what things are beautiful, what things or what conduct indicates refinement or culture, are based on the price system. We often judge paintings by the price marks, singers by the fees they receive, people in general by the apparent expensiveness of their clothes or cars. Walnut and mahogany look "rich" and are therefore used by the "better classes" for furniture and paneling; fur coats are worn in climates where cloth coats would be warm enough, because fur coats are "honorific evidence of the owner's prepotence" —to quote Thorstein Veblen.[8] The obvious possession of wealth is a "conventional basis of reputability"; and most evidences of wealth are reputable and beautiful and good.

One of the most obvious evidences of wealth is leisure, "abstention from productive work." Of course kings and nobles engage in no vulgarly productive work; they have lackeys and flunkies to do all that; Veblen tells of the king of France who "in the absence of the functionary whose office it was to shift his master's seat" sat "uncomplaining before the fire and suffered his royal person to be toasted beyond recovery. But in so doing he saved his Most

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[8] On this subject, see Thorstein Veblen's *The Theory of the Leisure Class,* from which the present author has taken many of his ideas on this question.

Christian Majesty from menial contamination." Doubtless the king was too stubborn in his observance of good form, but real aristocrats as a rule must give conspicuous evidence of innocence of productive work, evidence of "some ancient lineage, venerable, holy, ineffable, mellow with the antiquity of a hundred and fifty years, disinfected of the ancestral odors of salt cod, and pelts, all of a century ago, and unsmirched by a day's work since."[9] It is true that American businessmen do not observe this taboo very religiously; but most American businessmen are of the vulgar, newly rich class and have not yet had time to learn all the manners of well-seasoned aristocrats. It is the older families of New York that constitute the real "Four Hundred," families that are at least a generation removed from vulgar toil, families whose gentle blood has been "ennobled by protracted contact with accumulated wealth or unbroken prerogative." For some reason aristocrats think it more "honorific" to have ancestors who were able to make money than to be able to do it themselves.

In their styles and conventions, most men and women try hard to give an appearance of wealth and release from vulgar toil. Only the laboring classes appear in public in working clothes; even men of the middle classes appear at social affairs in dress suits, in starched shirts and collars which, although fundamentally ugly and uncomfortable, are obvious proof that the wearer could do no physical work.

Men of wealth commonly like to take their leisure "vicariously," by keeping their wives in honorable idleness. The women often wear high-heeled shoes, in which they obviously could do no ignoble physical work; they once wore tight corsets, even stronger evidence of emancipation from toil, they have small feet and hands (a generation or two ago the most threadbare of all jokes referred to "big feet"—evidence of vulgar physical work, or at any rate of a capacity to work), and their hands are not "dish pan" hands because their maids do the work; their fingernails are long, although not so fantastically long as the aristocrats of China used to wear, and are carefully polished or painted to show that the ladies engage in no menial work and that they have time to devote to such decorative activities, or money enough to hire a manicurist to do it for them. (It is probably not true, however, as a wag once suggested, that long fingernails are of rural origin—indicating that the women did not help with the milking!)

These refined ladies know all the rules of etiquette, many of which are irrelevant or silly but are evidence of leisure and of contact with others who have leisure to study such things. They talk about music, art, poetry, and the latest novels, which only leisure-class people can study, just as their husbands talk about "games, sports, and fancy-bred animals, such as dogs and rare horses," expensive, "honorific," leisure-class activities in which only men of wealth can indulge. A farmer who talks about hogs at a dinner party would hardly "rate" socially, for the raising of hogs is a productive business; yet a wealthy banker who has a show farm and raises pure-bred hogs at a loss for the fun of it could doubtless talk about his hogs without losing caste. Similarly it would not be well to talk too much about work horses, but a sportsman who can discuss race horses with understanding has "the conventional index of reputability," an index quite as unmistakable as skill in mixing highballs. In the same way, fishing suggests leisure and is a very stylish subject for discussion among the better classes.

Wealth and leisure, as Veblen pointed out, are also indicated by "quasi-scholarly and quasi-artistic accomplishments, and a knowledge of process and incidents which do not conduce directly to the furtherance of human life"—that is, by a knowledge of useless things. Veblen believed that the study of Latin is based partly on this principle; and there can be little doubt that our insistence on the correct use of English and on correct spelling is somewhat related to our insistence on dressing for dinner and on dipping the soup away from rather than toward us. Correct use of English is really of much less social importance than a knowledge of economics. People who say "ain't" and "has went" may thrive well and be peaceable and happy, but those who are ignorant of economics and the social sciences will be unable to solve critical social problems and will surely encounter disaster. Yet English is more commonly a required course for college students than any of the social sciences. The idea seems to be that even economic illiterates should speak grammatically, and if they wind up in social disaster they should do it as gentlemen. It takes time to learn to use correct English, which means leisure and financial competence. One cannot be mining coal or swilling the hogs and studying the mysteries of spelling and usage at the same time. Correct English is evidence of partial exemption from "vulgarly productive work." Knowledge of music and the fine arts, similarly, is usually thought much more "honorific" than knowledge of plumbing or housekeeping or farming, although there is no evidence that the study of music and the fine arts develops a particularly strong or fine character.

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[9] Mark Twain, *The $30,000 Bequest.*

Conclusions

In conclusion, then, we see that the price system—relative prices—regulates the production of goods, the consumption of goods, and the flow of income to individuals and classes *to the extent that the economic system is competitive*, and even determines some of our ideals. As we have already seen, however, all urban industry is infected more or less with monopoly, and to the extent that monopoly prevails, the price system does not perform all these functions effectively. The high prices which indicate a scarcity of aluminum do not induce producers to enter the field and enlarge the supply, because the aluminum monopoly has a tight fence around its business and others cannot get in; furthermore, the monopoly itself does not wish to enlarge the supply because this will reduce its prices and profits. On the other hand, excessive supplies and low prices in highly competitive industries such as farming do not necessarily drive producers out, because they cannot get into the fenced-off monopolized industries where prices and profits are high. To the extent that there is monopoly, society does not secure the maximum output from its productive agents. Under monopolistic competition the price system operates somewhat better, although still imperfectly. A high price for Schick razors cannot attract producers into the business of making *Schick* razors, because they are patented, but it may induce producers to undertake the manufacture of other brands of electric razors and so enlarge the total supply of electric razors and perhaps bring prices down.

QUESTIONS

1. What is a market? How big may a market be? Where is the market for wheat? For gold? For United States bonds? For common brick? For Sunkist oranges? For Texas watermelons?
2. What different forms may competition take? If the lumber companies were to agree as to the prices they charge, would competition be eliminated? Give illustrations of markets where price competition has been eliminated. In each case, what sort of competition has been substituted for it? Suppose Kansas were to pay $50,000 a year to her governor; what competition would develop?
3. How does pure competition differ from perfect competition?
4. "A prudent person will endeavor to distribute his expenditures among all sorts of uses, present and future, in such a way that they will have in each the same marginal utility." In estimating the present marginal utility of a future source of pleasure, what allowances must be made?
5. It is often said that a successful speculator, that is, one who makes money, benefits the community, whereas an unsuccessful one is a social detriment. Under what circumstances is this true?
6. Define pure competition, monopoly, duopoly, oligopoly, monopsony, duopsony, oligopsony, monopolistic competition.
7. Is it strictly correct to say that in considering the purchase of a pair of shoes a man weighs the utility of the shoes against the utility of his money?
8. Exactly why is there no advertising in the sale of wheat and raw cotton? If consumers were

perfectly informed and perfectly rational, would the markets for clothing, canned goods, and many other commodities be purely competitive? What other condition or conditions would have to prevail?

9. "Good use of English, good manners, high-heeled shoes, small feet, long fingernails, corsets, stiff collars, knowledge of dead language, music and the fine arts: all help to raise social standing because they indicate leisure—uselessness, parasitism." Do you agree? Why, or why not? Why should we not honor useful work and useful workers, rather than parasites?
10. Why do many people take more pride in distinguished ancestors than in doing notable work themselves? A distinguished historian once said that the people who came over on the *Mayflower* were the riffraff of England. Why are people so proud of being descendants of the *Mayflower* passengers?
11. Veblen said: "A breach of the proprieties in spelling is extremely annoying and will discredit any writer in the eyes of the persons who are possessed of a developed sense of the true and beautiful. English orthography satisfies all the requirements of the canons of reputability under the law of conspicuous waste. It is archaic, cumbrous, and ineffective; its acquisition consumes much time and effort. failure to acquire it is easy of detection." Is this the only reason for requiring courses in spelling and rhetoric?

Chapter 14.

Market Price

In the preceding chapter we described briefly the various possible market situations, particularly those known as pure competition, perfect competition, monopolistic competition, and monopoly. We saw that only in a few agricultural markets, for instance those for wheat and cotton, is there anything approximating *pure* competition, even on one side of the market; that there is no *purely* competitive market and, even more definitely, no *perfectly* competitive market; and that practically all urban industries represent limited monopoly or monopolistic competition. Although there is no such thing as pure competition, it is necessary in the present chapter, if we are to do anything at all with our problems, to analyze some market situations as if they were purely competitive, somewhat as the physicist in some of his analysis assumes a vacuum and ignores friction. This will not be seriously misleading. The principles of competitive price determination are important even in markets where there is a considerable measure of monopoly control. In the market for oil products, for example, although the Standard Oil companies have some monopoly control, they cannot ignore competition, and the principles of competitive price determination are to some extent valid.

Prices in different periods of time

The problem of price determination differs with the period of time under consideration; accordingly we shall analyze competitive price as determined in three different periods: (1) the market price period, (2) the short-run normal or intermediate price period, and (3) the long-run normal price period.

1. *Market price period.* In the market price period the supply *in existence* is assumed to be fixed, for the time is too short to permit any more to be produced. Generally, however, the amount that will be *put on the market* varies with the price. In this price period costs of production play no part, but the price must be high enough to cover (a) the cost of bringing the product to the market, and (b) the cost of foregoing other possible uses of the product.

2. *Short-run normal or intermediate price.* In this period, supply is assumed to be what can be produced *with the existing plant and managerial staff.* The supply can be increased to some extent, and so costs of production enter into the problem, for the price must be high enough to cover at least the costs of the labor and raw materials and the other direct expenses of production, but not necessarily high enough to cover fixed costs, the interest and depreciation on the fixed plant.

3. *Long-run normal price.* In this period, of perhaps several years' duration or even longer, there is *time for the production of new plant;* and the price is assumed to cover not only the costs of labor and materials and other direct costs, and the salaries of the managerial staff, but also interest and depreciation charges on the fixed plant. Long-run normal price may best be defined as *the price which would be established if the conditions affecting demand and supply remained stationary for a time long enough to allow them to work out their effect*

fully. It is the price about which the market price is constantly oscillating and toward which it is constantly tending, but which it touches only briefly in its fluctuations.

An illustration of the three periods

To illustrate the principles governing price in a competitive business in each of these three periods, let us consider the price of apples. In October there is a certain supply of apples in existence, a fixed supply which cannot be increased before the next year. It makes no difference for the present what it cost to produce these apples; they are here in a certain fixed amount, which must be sold or disposed of in some way before the next crop is picked. Here we have the essentials of the market price period. The amount of apples *put on the market* depends to some extent on the price, for if the price is very low some of the poorest apples may not be picked, or they may be fed to the hogs, and some of the good apples may be kept by the producers, perhaps canned for future use. Although we assume that costs of production, the costs of *growing* the apples, do not affect market price, there are two elements of cost that do affect the amount of apples put on the market, and therefore the price: (1) the cost of picking and bringing them to the market, and (2) the cost represented by foregoing other possible uses of the apples such as feeding them to the hogs or canning them for home use. The higher these costs are, the smaller the supply that will be put on the market and the higher the price will be. Costs, in these two senses only, do affect price, even in the market price period.

Now if the price of apples is just high enough to cover costs of production for practically all producers, there will be no incentive for either increasing or reducing the supply. By costs of production we mean the wages of the labor, the cost of any raw materials such as fertilizer and the like, interest on the investment in the orchard and equipment—the orchard and storage facilities represent the fixed plant—and wages of management for the producer. If the price of apples covers these costs, those in the business will continue producing about the same amount the next year, and no outsiders will find it worth while to enter the business. If the price in October just covers these costs, it is not only the market price but also the short-run and long-run normal price.

But suppose the price of apples is considerably *above* costs of production, and producers are making large profits, as in 1942. Here is an unstable situation. There "should be" more apples, and the forces are in operation which will tend to increase the supply and reduce the price. The number of bearing trees, the fixed plant, cannot be increased in less than about ten years, for it takes about that time for trees to reach bearing age. Adjustment of supply through increasing the fixed plant—the long-run normal adjustment—cannot be reached in less than ten years; but in the meantime, in the short-run normal period, apple production can be increased to some extent by cultivating the orchards more intensively, by applying more labor and capital in tilling and fertilizing the ground, in spraying the trees to kill insect pests, and in other ways. The higher the price of apples, the more care will be given the orchards; but the price may remain above the average total cost throughout the short-run normal period, until new trees can come into bearing. When the "plant" has thus been expanded, the supply of apples should be sufficiently enlarged to bring the price back to cost of production, the long-run normal price, unless further changes in demand or in costs call for further adjustment. Perhaps by the time the new trees have begun bearing, the demand will have increased further, with the result that the supply will still be too small to bring the price down to cost of production; or the demand may have declined, with the result that the supply is now so great as to force the price down below cost of production. In either case the long-run normal price has not been reached, and years of further adjustment will be needed before it can be reached; indeed, it is seldom or never reached, because conditions are continually changing and making new adjustments necessary.

Let us now suppose that the market price of apples in October is *below* cost of production, with most or all producers losing money. Here again is an unstable situation, and the forces are in operation which will tend to reduce the supply and bring the price up to the cost of production. If the price is too low to cover even the costs of cultivating the orchards, of spraying the trees and picking the apples—the variable expenses—some orchards will be abandoned and perhaps cleared of trees. The short-run normal price must be at least high enough to cover these expenses. If the price is this high, however, the producers may not abandon their orchards in the short-run normal period, even though they earn nothing on their fixed expenses, their investment in orchards. But they will not replant the trees that die, and will not spend as much on the care of the orchards as they would if apples brought a higher price. Through the gradual decay of the trees and in other ways, the supply will tend to be reduced until the price again reaches the level set by the full cost of production, the long-run normal price.

Competitive price is determined by the interaction of demand and supply in all three periods, but the relative emphasis given to supply and to demand is not the same for all three periods. In the market price period, only two costs are considered—the cost of bringing the product into the market and the cost of foregoing other uses of it. In the short-run normal period, the price must cover these two costs and also the *variable costs* of production. In the long-run normal period, the price must cover *all* costs, including *fixed* costs.

The market price period

It is impossible to be precise as to the duration of the market price period, because it varies with different commodities and with conditions. In the wheat market, for instance, it might well be thought of as an entire season, for once a wheat crop is harvested there can be no increase in the domestic supply until the next season. Yet the price of wheat changes from hour to hour and from day to day throughout the season, largely because of changes in conditions of demand; and for some purposes a period shorter than the season might serve. The "cash wheat" supply in the Chicago exchange might be regarded as the supply at a given instant or for an hour or perhaps for a day. At a given instant, the supply would be strictly limited to the wheat in the Chicago elevators and freight yards; in an hour, some wheat could be shipped in from points perhaps thirty miles distant; in a day some could be shipped in from Minneapolis. It is impossible to be very explicit here, but at any rate we must think of the market price period as a period so short that the amount in existence cannot be changed, and therefore so short that costs of production cannot affect the price very much.

Market prices are real prices

Market prices, as Bye points out, are *real* prices, "the prices which actually exist," as contrasted with the normal prices which would prevail if conditions remained the same for a long enough time for cost of production to play its part; and there is a wide economic area in which the principles governing market price are very important, a wide area in which market prices often deviate widely from cost of production or have little or no relation to it.

There are a great many non-reproducible goods whose prices bear practically no relation to cost of production, such as Rembrandt paintings or those of any great "master," Stradivarius violins, precious first editions—a first edition of Adam Smith sells for at least $150—autographed copies of famous books, genuine antiques, rare stamps, and natural resources of all kinds. The prices of natural resources are of course unrelated to cost of production only *as natural resources* in the place and form in which nature provides them, and not as found and processed and brought into the market; for there is the cost of finding some of them, and practically all of them must be "made over" more or less and brought into the market, perhaps at high cost.

The prices of certain other goods are largely governed by cost of production in the long run, yet may deviate widely from cost at times, or even most of the time. Here we may include most agricultural products. Because of the vagaries of the seasons, shifting demands, and the considerable time that must elapse between preparation for a crop and harvesting it, market prices of many agricultural products may be far below or above cost of production much of the time. An orchard planted this year will yield nothing for ten years, and then it may be worthless because too many orchards have been planted and the market has been glutted or because there has been a shift in the demand which cannot be predicted ten years in advance. Hundreds of orchards planted in the roseate years of the First World War and the following decade proved worthless in the Great Depression, because fruit prices were too low to cover even the costs of caring for the trees and picking and marketing the fruit.

Urban businesses have similar risks and are not always able to cover costs of production; but the prices of manufactured products are more commonly high enough to cover costs than are the prices of farm products. Manufacturers have some control over their prices, and they usually set them at levels which they calculate will cover costs, and limit output to the amounts that can be sold at those prices. Merchants ordinarily determine upon a certain "mark-up" which they apply to the goods they sell, a mark-up based on their estimate of costs, including what they call a fair profit.

In times of severe depression, or in a sudden burst of prosperity such as often accompanies a war, many market prices, even of manufactured products, may shift far from the cost of production level. In the business depression of 1921 and again in 1929, many merchants were obliged to dump some of their goods at prices far below cost. Since business conditions are usually changing with the fluctuations of the business cycle, market prices are often considerably below or above cost of production. The concept of market prices is of real importance.

Demand defined

Before proceeding further with our discussion, it will be necessary to define demand and supply more carefully. Demand means more than "desire." A penniless urchin looking in the window of a bakery does not demand cakes and has no effect on the price of cakes. His demand must be "effective"—must be backed by money and by the willingness to spend the money for cakes—before he enters the price-making process.

Individual demand is sometimes defined as the amount of a commodity that an individual stands ready to buy *at a given price;* but this is not an adequate definition, for it gives us only a glimpse of the individual's real demand. If we know only that at 5 cents each, a man will buy 10 apples, we know little about his demand. With only this much stated, we have no idea as to how many he would buy at 4 cents, or 3 cents, or at any other price. We should therefore define his demand as *a schedule of all the various amounts he stands ready to buy, at a corresponding schedule of prices, at any given time and place.* This definition gives us a much broader conception of the individual's demand. For instance we may assume that he will buy:

0 apples at 10 cents each
1 apple at 9 cents each
2 apples at 8 cents each
4 apples at 7 cents each
6 apples at 6 cents each
10 apples at 5 cents each
15 apples at 4 cents each
20 apples at 3 cents each
30 apples at 2 cents each
50 apples at 1 cent each

Here is an individual demand schedule which offers a much more complete picture of his want and his ability and willingness to satisfy it than would the mere statement that he will buy 10 apples at 5 cents each. Drawing a graph for a part of this schedule, we have the curve shown in Fig. 5. In this graph, which is typical of many that the student will encounter in this book, we measure quantity along the line *OX* and price along the line *OY;* and we are able to see at a glance just how many apples will be demanded at each of the various prices. The graph even shows the number demanded at every fraction of a cent.

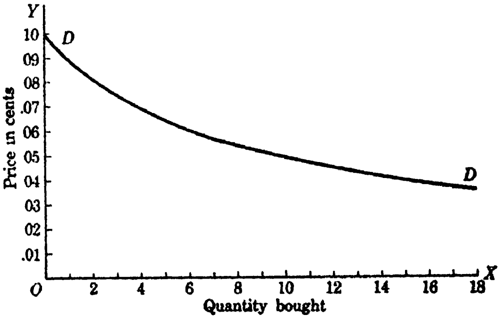

FIG. 5.

Not all individual demands can be defined as schedules. At any given time a man usually wants only one watch, one automobile, one piano, one house to live in; and for such commodities the individual demand curve will not serve well. But the total demand in the market, even for such commodities, should be thought of as a schedule.

The individual demand curve always slants downward, to the right, because of the law of diminishing utility. The individual may satisfy his most important wants at a high price, but since, according to this law, additional units of the commodity satisfy less important wants, they must sell at a lower price or he will not buy them. Rather than buy more at the same high price, he will turn to other goods that are always competing for his attention, for at every point in his demand schedule he is presumably apportioning his purchases among different commodities in such a way that the marginal utilities of the goods costing equal amounts will be equal.

Ordinarily, the word demand does not mean individual demand, but the demand of all the buyers in the market, the *total* of all individual demands, or the *aggregate* demand. It is impossible to picture a total of a great many individual demand curves, but we may construct a schedule and draw curves for a few buyers; such a schedule is shown in Fig. 6. In this graph curve *A* is the individual demand curve for buyer A; curve *B*, measured from curve *A* and not from the line *OY*, is the demand curve for buyer B; curve *C*, measured from curve *B*, is the demand curve for buyer C; and curve *D*, measured from curve *C*, is the demand curve for buyer D and is also the aggregate demand curve.

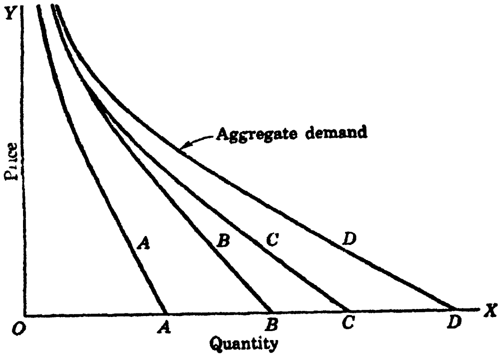

FIG. 6. Demand Curves of Individuals *A, B, C,* and *D.*

Aggregate demand, the demand of all the buyers in the market, is often defined as the amount which buyers will purchase at a given price, at a given time and place; but again this is inadequate. We should rather define aggregate demand as *a schedule of all the various amounts that consumers stand ready to buy at a corresponding schedule of prices, at any given time and place.* Only as a *schedule,* graphed as a curve, is demand adequate to serve in fixing price.

Change in demand

A change in demand means a shift in the demand *schedule* or *curve;* it means that buyers will purchase more at *all* the prices indicated on the curve, or that they will buy the *same amounts at higher prices.* The mere fact that they buy more at lower prices or less at higher prices does not indicate a changed demand. They will do that without any change in the schedule or curve, for that is exactly what the schedule or curve means. But when they buy more at the same prices, or the same amounts at higher prices, the demand has obviously increased. A change in demand may be graphed as shown in Fig. 7.

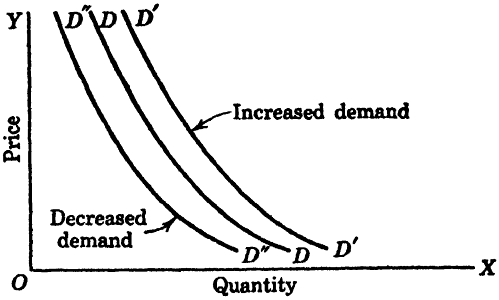

FIG. 7.

Changes in demand may result from (1) changes in income, (2) changes in consumers' tastes or preferences, or (3) changes in the prices or availability of *other* goods.

1. Buyers buy with *money.* Demand is the various amounts of *money* that they will give for corresponding amounts of the good in question; and if the buyers find themselves with increased or decreased money incomes they can and will pay more or less for any given amount of the good, other things—their tastes and desires, for instance—remaining the same.

That is, demand increases with increases in the incomes of buyers, and declines with decreases in their incomes. In the two world wars, for example, consumers had higher incomes; this resulted in increased demand for most products, and therefore higher prices.

2. Changes in demand may result from changes in the tastes or preferences of buyers. When, for instance, it was discovered that liver, formerly a cheap by-product of the meat-packing industry, contained important vitamins, the demand for liver increased sharply. Consumers' food preferences have changed considerably in past decades; the demand for many vegetables—particularly those that have important vitamins, such as tomatoes, cabbage, and carrots—for citrus fruits, sugar, and dairy products has increased, whereas the per capita demand for potatoes and cereal products, particularly flour and corn meal, has declined. It is said that the Popeye news strip had a definite effect on the consumption of spinach. In the market for more durable goods, the shift of public demand from big to small houses left many old mansions almost unsalable.

3. Changes in prices or in the availability of other goods may affect the demand for any particular good in one way or another. Here, however, we must make a distinction between complementary goods and competitive or "substitutive" goods. Complementary goods are those that are used together for any given purpose, goods for which there is a "joint demand," such as gasoline and tires; Victrolas, records, and needles; beer and pretzels. A higher price for one complementary good is likely to result in a reduced demand for the other. A higher price for gasoline, for instance, will reduce the use of automobiles, although not very much, and will therefore reduce the demand for tires; higher prices for Victrolas will reduce the sales of records and needles.

For competitive or substitutive goods, the situation is reversed. Substitutive goods are those which compete for the buyers' favor, which may be substituted for each other to some extent as their relative prices change, such as Post Toasties and Corn Flakes, apples and oranges, beef and mutton. Most goods are classified as substitutive with respect to each other, for to a greater or lesser extent each of them may be substituted for every other as their relative prices change. A rise in the prices of other substitutive goods generally increases the demand for any particular good, and a fall in their prices tends to reduce the demand for this good. A rise in the price of Post Toasties, for instance, other conditions remaining the same, will cause some buyers to turn away from Post Toasties and so will increase the demand for Corn Flakes; a rise in the price of oranges will increase the demand for apples. If, however, the higher price of Post Toasties is the result of a greater demand for *all* cereal foods, the price of Corn Flakes may rise too. The demand for every commodity is to some extent related to the demand for every other commodity which may be substituted for it.[1]

The aggregate demand curve always slopes downward to the right, even more certainly than the individual demand curve, because, while an individual might conceivably buy more of a commodity at a high price than at a low price—to show his capacity for conspicuous waste—in the great body of buyers in the market his influence would certainly be outweighed by that of the other more rationally-minded buyers. More of a given good can be sold only at lower prices because of the law of diminishing utility and because of limitations in the purchasing power of buyers. Some buyers will buy a few units at higher prices but more only at lower prices, because additional units have a lower marginal utility; others will buy none at higher prices, perhaps because they do not care much about the good, but will buy some at lower prices; and still others, to whom the good may have high utility, may be out of the market at high prices because of lack of purchasing power, but may be able to buy at lower prices.

High or low vs. rising or falling prices

We must distinguish clearly between high or low prices, on the one hand, and rising or falling prices, on the other. This is very important, because the influence of the *height* or *lowness* of a price is very different from the influence or a *rise* or *fall* in price. The general rule of demand is that *the more of a good there is to be sold, the lower must be the price,* that is, the demand curve always slants downward; yet a *rise* in prices, in the short run, is quite as likely to cause an increase in buying as a decrease, and a *fall* in prices often brings not an increase but a decrease in the amount demanded. Particularly when prices have risen for some time, buyers are likely to anticipate further price increases and to buy in anticipation of future needs; while in a period of falling prices they are likely to stay out of the market in the expectation of further declines. During the First World War, for instance, and for a time afterward, the price of sugar rose steadily, and toward the end of that price rise sugar purchases were very heavy. On the other hand, in a long decline in the prices of commodities and stocks, purchases often decline with prices, at any rate after the decline has run for some time. At the bottom, buyers seem reluctant to enter the market at all; but if they feel sure that the bottom has been reached, they will buy more than they would at higher prices. This is proved by the fact that clothing merchants, for example, offer left-over clothing at reduced prices after the ordinary buying season is over, and so dispose of what they could not sell at higher prices.

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[1] An excellent analysis of this is given in Mary Jean Bowman and George L. Bach, *Economic Analysis and Public Policy*, chap. 3.

Applying this analysis to Figs. 5–7, we see that no time must elapse from one part of the demand curve to another. The curve is a "snapshot" of the demand at a given time, hypothetical of course as to all prices but the one that actually prevails.

Elasticity of demand

Although the demand curve always slopes downward to the right, its slant—the *elasticity* of the demand, that is, *the extent to which changes in the price affect the amounts purchased*—differs for different commodities. The demand for some commodities—certain cuts of meat, for instance—is fairly elastic. The demand for certain other commodities—sugar and salt, for example—is very inelastic. The demand for still other commodities is said to be *unity,* by which we mean that changes in price result in such changes in the amount demanded that the amount bought multiplied by the price yields the same total for all prices; that is, the total amount spent for such a good is the same whatever the price. In strict terminology, a demand is elastic if it is more elastic than unity; that is, if as the price rises the total amount spent for the good declines, and as the price falls the total amount spent for it increases. A demand is said to be inelastic if it is less elastic than unity; that is, if the total amount spent for it is greater at higher prices and less at lower prices. This is the strict meaning of the terms. We shall not always be so precise, however, but will use the terms in a more general sense to indicate whether the amount demanded changes much or little with changes in price. An elastic demand curve slopes downward to the right, but not much; an inelastic demand curve slopes steeply downward to the right. A demand curve of unity elasticity slopes downward to the right at such a rate that, at every point on the curve, lines drawn horizontally to the left, to the Y axis, and vertically down to the X axis, will enclose the same area. Such a curve is a rectangular hyperbola. We know less than we should about the elasticity of the demand for different commodities, but a few generalizations may be ventured.

1. To the extent that we can define necessities and luxuries, we may say that the demand for necessities is inelastic and the demand for luxuries elastic; but these terms are hard to define precisely. Adam Smith once made the mistake of classifying tobacco as a luxury, but when he came to the discussion of taxation, he observed that men would buy tobacco when they could not afford what he considered real necessities. There are still a few people who think of automobiles as luxuries, but cars have become almost a necessity in recent years, as is evident from the economic disruption caused by the scarcity of rubber during World War II. On the other hand, milk might seem to be a real necessity, at least for children; but there are some people who cannot afford much of it, even though they drive automobiles.

Food products in general are certainly necessities, and the demand for food is rather inelastic. This appears clearly in the fact that when food prices rise, or when, in a depression, incomes decline, the grocery business suffers less than most other businesses, although there is a shift from the more expensive to the less expensive kinds of food. For food products that are very cheap the demand is inelastic—salt for table use, sugar, bread, and some of the cheaper vegetables. But, as Marshall points out, in India, where the price of salt is high and the people are poor, the demand is elastic. The cheaper kinds of clothing are necessities, and the amount bought does not decline much in depression times; it may even increase as incomes go down and buyers fit the cloth to their purses.

For luxury articles, the demand is likely to be elastic. It is true that the rich and the very rich can buy most of the things they want, regardless of price, but even the rich want their money's worth; in fact, some of them are very careful and judicious in their spending, and when an article rises considerably in price they will turn to other things. There are always marginal purchasers of luxury articles, a rather large proportion of the reputed rich, who are straining themselves to buy such things, in a noble effort to keep up with the Vanderbilts, and will be obliged to drop out of the market if prices rise much. Some things are luxuries even to the very rich—yachts, palatial homes, baronial estates, art galleries, rare wines—and for these the demand is elastic.

2. In general, the demand is elastic for those goods for which there are satisfactory substitutes; but the word "substitute" needs careful definition. It is a relative term, like most terms used in economics. What is a substitute for Blue Boar smoking tobacco, for instance? First of all, some other particular brand of smoking tobacco, for probably there is one brand more nearly like Blue Boar than other brands are; the different brands might be arranged in a series, according to their likeness to Blue Boar. Thus we have a considerable number of close substitutes. There are other substitutes, not so close, yet likely to be used to some extent if the price of Blue Boar rises high enough: many brands of cigars and cigarettes, and perhaps snuff. Still more distant substitutes might be candy—"Reach for a Lucky instead of a sweet"—coffee, Coca-cola, wine, whisky, books, automobiles, clothes, indeed almost everything! Practically every conceivable good is competing with Blue Boar for the consumers' dollars and may be substituted, marginally, if the price of Blue Boar rises high enough.

If there are fairly satisfactory substitutes for a good, the buyers will shift to these if the price is raised very much. Thus there is an elastic demand for beef, pork, or mutton, because other kinds of meat will serve well as substitutes; but there is a relatively inelastic demand for *meat*, and of course a much more inelastic demand for *food*. Likewise there is an elastic demand for any one brand or make of a good—*Ford* cars, *Old Gold* cigarettes, *Waterman* pens, *Chase and Sanborn* coffee, but a relatively inelastic demand for cars, cigarettes, pens, or coffee. Advertisers are sometimes able to build up a surprising loyalty to certain brands, a loyalty based on the notion that these brands have very exceptional qualities; but generally the demand for a given brand of a good is far more elastic than the demand for the good itself.

3. Demand is likely to be more elastic for those goods which call for a large proportion of the consumers' total expenditures than for those that are relatively unimportant. The demand for meats is more elastic than the demand for some of the unimportant articles of diet like sugar or salt, partly because meats bulk large in consumers' budgets. Consumers are likely to feel the pinch of higher meat prices keenly. Similarly, an increase in the price of new houses or Ford cars would probably reduce the number demanded more than a proportionate increase in the price of matches, or razors, or other small articles, particularly if these articles are bought only occasionally.

4. As Marshall points out, things which are capable of being applied to many different uses have generally the most elastic demand. This may be illustrated by Fig. 8. It is clear

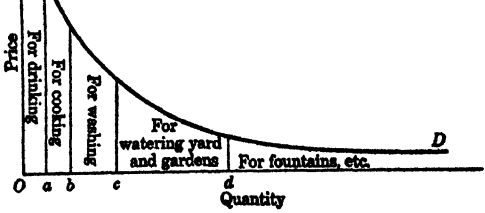

FIG. 8. The Demand for Water.

from this diagram that were it not for the various uses of water, the demand curve would be much steeper. If it were used only for drinking, the curve would slope down to point *a*, or to a point not far from *a*, because people drink only a certain amount of water, no matter how low the price. If water were used only for drinking and cooking, the curve would slant down to point *b*, or a little to the right of it, because people want only a limited amount of water for cooking, no matter how cheap it is. In each case it is the next lower use which pulls the demand curve over to the right—makes it elastic.

Many goods are like water in the fact that they can be applied to different uses, and the demand for such goods has a high elasticity at very low prices. If water were cheap enough, it would be used not only to irrigate yards and gardens, but in fountains to cool the air, in private swimming pools and even small lakes. Similarly, if salt, which has an almost absolutely inelastic demand for table use, were cheap enough, it might be sprinkled in great quantities on railway roadbeds to keep down weeds and grass; if petroleum were very cheap, cheaper than coal, it would almost completely displace coal for fuel uses; if copper were cheap enough, it would displace iron and tin for many building purposes; when corn prices fall very low, farmers sometimes burn corn as fuel; and when wheat prices fall to the level of corn prices, wheat is used to feed livestock, the result being a greatly increased consumption. There would be an almost infinite expansion in the use of many such commodities if their prices were low enough.

5. In general, the demand for *durable* goods has greater elasticity, in the short run, than the demand for goods which are used up in a short time, because the purchase of durable goods can be postponed. This is one important reason why the building industry declines so greatly in periods of depression. People who would otherwise build new houses find that they can use their old ones a few years longer without great hardship, and therefore fall out of the market. Here is also one of the reasons why the sale of new cars declines so much during a depression, much more than the sale of gasoline for instance, and why sales of house furnishings and clothing decline more than sales of groceries. Such demands are merely postponed; they will make themselves felt eventually, but not perhaps for several years.

6. Finally, a *joint demand* is likely to be rather inelastic, and may be highly so. A large proportion of the goods bought and sold, particularly raw materials and capital goods, is subject to joint demand. The demand for cement, iron, steel, copper, brass, aluminum, glass, lumber, building stone, and some kinds of labor is a joint demand—"joined" to the demand for the other materials and services used —and is generally inelastic. The often-noted stability in the price of steel has been partly due to the fact that steel producers know, as Yntema has recently demonstrated from statistical studies, that the demand for steel is highly inelastic, and that therefore changes in the price will not greatly affect the amount demanded. For many purposes it is an essential material, and yet its cost may constitute only a small proportion of the *total* costs, so that changes in its price may affect the amount bought very little.[2]

This principle applies not only to many raw materials and partly finished goods used in the production of capital, but also to raw materials used in making consumers' goods, and to some consumers' goods themselves. It explains to some extent the inelasticity of the demand for many farm products. The demand for flour in making bread, for instance, is a joint demand for the flour and other ingredients used, and for the labor employed in baking and distributing the bread. Only two or three cents' worth of flour is used in making a ten-cent loaf of bread, and therefore a rise in the price of flour has only a modest effect on the price of bread, and on the demand for flour. Obviously this is also true of the other ingredients of a loaf of bread. Similarly, only a dollar's worth of tobacco goes into seven dollars' worth of cigarettes; only 18.7 cents' worth of tomatoes is used in a dollar's worth of canned tomatoes. A rise or fall in the price of the raw material, in such cases, does not change the price of the finished product very much, and so does not greatly affect the amount of the raw material demanded.

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[2] See Edwin G. Nourse, *Appraising the Responsiveness of Market Demand*, Brookings Institution, 1942.

Somewhat different is the joint demand for consumers' goods necessarily used together, such as the demand for automobiles, tires, and gasoline, for guns and ammunition, for golf sticks and golf balls, for beer, Limburger cheese, and pretzels. In the case of automobiles, tires, and gasoline, it is clear that since tires are essential to motoring and since tire cost is only a small part of the cost of motoring, the demand for tires is highly inelastic. There is conclusive evidence that the demand for gasoline is similarly very inelastic.

Relation of changes in amounts supplied to changes in price

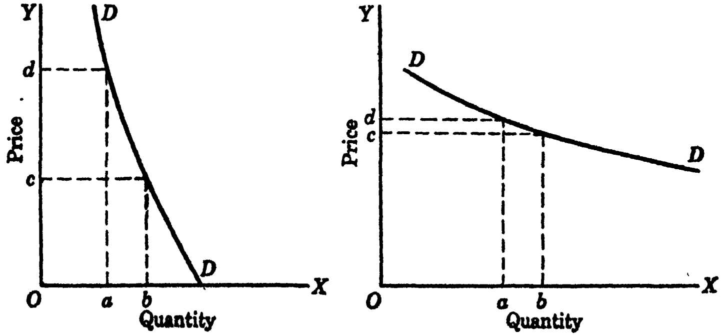
A principle of considerable importance in economics is that *the extent to which the prices of different commodities change with changes in the amounts supplied varies inversely with the elasticities of their demands.* Commodities for which the demand is inelastic are likely to vary widely in price with small changes in the amounts supplied, while commodities subject to elastic demand do not vary greatly in price. This is illustrated graphically in Fig. 9. It appears that in the case of a good that is subject to inelastic demand, a reduction from *b* to *a* in the amount supplied raises the price from *c* to *d*, or about 100 per cent, whereas a similar reduction in the supply of a good subject to elastic demand raises the price only about 10 per cent.

Our illustrations of this principle need not be hypothetical, for there are many actual examples. A small crop of cotton is often worth more to the producers than a large one. A small increase in the wheat crop sometimes forces the price down disproportionately, and a small shortage in the supply brings a disproportionate increase in the price. This is one of the reasons for our government's recent efforts to prevent the production of too large crops of grain and cotton.

Supply defined

Turning now to the supply side of our problem, we find supply sometimes defined as the amount which will be put on the market at a given price; but this is inadequate, for it indicates only the supply at a single price. In the problem of market price, supply should be defined as a *schedule of all the various amounts that sellers will put on the market at a corresponding schedule of prices, at any given time and place.* The limitation to a "given time" suggests that, as in the case of demand, the supply schedule or curve is a "snapshot" picture, hypothetical as to all prices but the one actually prevailing. The demand and supply schedules represent *hypothetical,* not actual amounts. Inevitably this must be true, because at any given time there can be only one price, and the other amounts in the schedules must be estimated from whatever data are available. A number of able economists are working on the problem of constructing demand and supply schedules from actual data, and our knowledge of such schedules is growing steadily.

The amounts that *would be bought and sold* at any time are influenced by a great many factors: by the possibility of storage, and by judgments as to future conditions of supply



A. Inelastic demand

B. Elastic demand

Fig 9.

and demand and future changes in the prices of commodities. The present market conditions for storable goods are always affected by anticipations of future conditions; thus sellers of such goods are likely to hold back much of their supplies if they think the price too low, but if they anticipate a further price decline they may increase their offerings. The market conditions for any one good are greatly influenced by conditions for competing goods; for instance, a heavy apple crop and cheap apples in the central states reduces the demand for oranges. The market conditions for any one commodity may be more or less influenced by the conditions and prices of a vast number of other commodities, even those that are only slightly competitive, through the latter's effect on the amount of money left in the hands of buyers and sellers, and in other ways. If all such relationships are traced, the problem of price becomes complicated indeed.

Perfectly inelastic supply

In some markets, the entire supply is offered without reservation. The best illustration of this is an auction. Farmers on retiring from their farms often dispose of their goods in this way, and there are occasional auctions of jewelry, furniture, and antiques, often with more "reservations" than are apparent to the public. California citrus fruit is commonly sold at auction.[3] The markets for farm truck crops—melons, berries, tomatoes, and vegetables—approximate an auction rather closely, for the farmers and truck growers usually sell almost all their products regardless of price. Yet market conditions shift from day to day; and if prices go too low, sellers may decide to keep more for home use, to hold part in storage if the product is not perishable, or to send part to other nearby markets.

A situation much like this is found in the marketing of stocks of clothing which is unsold at the end of the regular buying season and would be out of style by the next season, and of many kinds of goods at the onset of a severe depression. In these cases, there is a fixed or nearly fixed supply of goods which must be sold; and, although the sellers do not dump the goods on the market as at an auction, they fix a price that will "clear the market," which amounts to the same thing.

The market situation where the supply is fixed, as in the case of an auction of oranges, may be graphed as shown in Fig. 10.

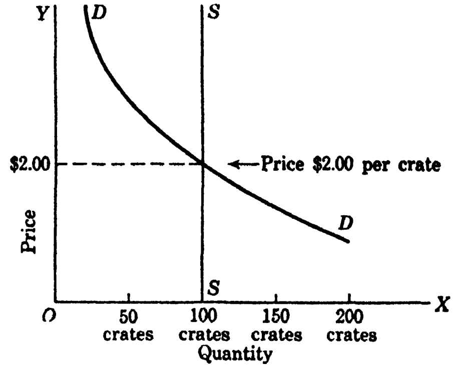


Fig. 10. Market for Oranges at Auction.

Supply with reservations

In many cases, however, not all the supply is dumped onto the market for what it will bring. Some of it may be offered at "reservation" prices, below which it will not be sold. In this case the supply *schedule* is made up of such portions, as well as those that are thrown on the market without reservation. In the stock and grain exchanges there are always sellers both with and without reservation—some who will sell only at certain prices, and others who sell "at the market." Likewise in the wheat market after harvest some farmers sell their output regardless of price, whereas others have reservation prices, below which they prefer to store their grain in the hope of a better price later. Where some of the supply is offered at reservation prices, the supply is of course elastic.

An elastic supply schedule, when graphed, takes the form of a curve that slants to the right as it rises, instead of the perpendicular line that characterizes inelastic supply as in an auction. A supply schedule for wheat, with the complementary demand schedule, may be constructed as follows and graphed as shown in Fig. 11.

---

[3] The California Fruit Growers Exchange does not offer its fruit indiscriminately and in unlimited amounts but releases it to the market in carefully regulated quantities to avoid "spoiling the market." Nevertheless, once its fruit is put up at auction, the price is determined as indicated.

Price (Per Bushel)	Supply Schedule (In Millions of Bushels)	Demand Schedule (In Millions of Bushels)
$ .30	300	680
.40	300	640
.50	300	600
.60	300	560
.70	300	525
.80	335	485
.90	370	445
1.00	*405*	*405*
1.10	440	375
1.20	475	355
1.30	510	340
1.40	545	330
1.50	580	325

It is clear that with the supply and demand schedules or curves shown here, the equilibrium price will be $1.00 and the equilibrium amount 405 million bushels. At $1.00, and at no other price, will the amount supplied and the amount demanded be equal.

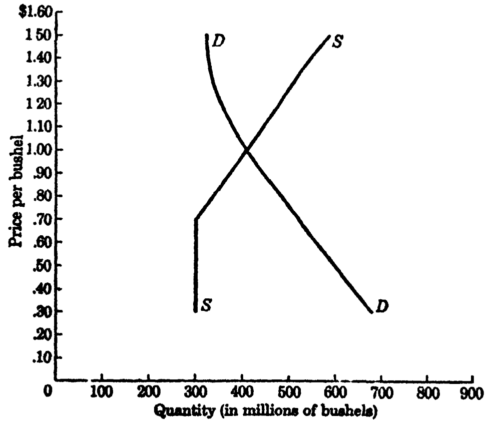


FIG. 11. The Market for Wheat.

Market outlines may appear slowly

It must not be assumed that the market adjustment, as it actually operates, is as prompt, exact, and automatic as our hypothetical schedules might seem to indicate. If the market is to work perfectly from the start, buyers and sellers must have accurate knowledge about prevailing conditions, and this is obviously impossible. In every market there are some buyers and sellers who do not know what the conditions of demand and supply really are, and it may therefore take a little time for the outlines of these schedules to appear clearly. Intra-marginal buyers may underestimate the supply and offer somewhat more than the actual conditions warrant; intra-marginal sellers may sell a few units at lower prices than they could have got; or both buyers and sellers may exaggerate the strength of their own position and stand aloof, with the result that the market price is slow to appear. There may be considerable jiggling of the price at first, just as there is in the pointer when a man first steps on a weighing machine.

Although these are as a rule not serious difficulties, they may be very serious in the labor market, as Marshall points out. If a laborer is in such dire need that he hires out at wages lower than the market warrants, he may go on selling his labor at this low rate. As a result, he is at a disadvantage in bargaining, and his low wages provide no reserves which will strengthen his position.

Common errors in regard to price determination

It should now be easy to see why we defined demand and supply as *schedules* of all the various amounts that will be demanded and supplied. As schedules, graphed as curves, demand and supply establish an equilibrium price at some point. To define demand and supply as the amounts that will be demanded and supplied *at a given price*—let us say 405 million bushels at $1.00, as in Fig. 11—is to *assume* the price which it is our task to explain.

By defining demand and supply as schedules or curves we avoid some other common errors. It is sometimes said, for instance, that when the price declines the demand increases; the truth is that the *demand schedule* does not change, but only the *amount demanded*. If buyers who formerly took 100 crates of oranges at $3.00 a crate now take 160 at $2.00, there is not necessarily any change in demand. An increased demand means that they will take more at the same price, or the same amount at a higher price, or both. A distinguished economist once said that the supply and demand theory of price involved circular reasoning, because if demand and supply determine price, price in turn determines demand and supply. Here we see the confusion between demand and supply *as schedules or curves* and *as*

amounts demanded and supplied at a given price. The supply and demand *schedules* do determine price; but price does not in turn determine the schedules, it determines only the *amounts demanded and supplied.* A well-known writer once stated that demand might change as the result of a skillful advertising campaign or a change in fashion or a change in price. Here we see once more the confusion between the *demand schedule* and the *amount demanded.* A skillful advertising campaign or change in fashion may change the demand schedule, or part of it, but a change in price does not cause a change in the demand schedule or curve.

From the preceding discussion of market price we can see the falsity of many common notions. It is sometimes said, for instance, in years when farm crops are large, that the supply exceeds the demand; but in any really competitive market this can never be so. The supply and demand schedules must be in equilibrium at the market price, and at this price the amount supplied and the amount demanded are equal. What is really meant by this complaint is that the supply and demand schedules are in equilibrium at a price lower than is desired. Similarly, people often speak of oversupply, overproduction, or shortage; but in the market there can be none of these conditions, but only lower or higher prices than we would like to see prevail. Some manufacturers complained of a shortage of labor in 1920, but this meant merely that wages were higher than they liked to pay. The logical answer to the housewife who once complained to the writer that she "just couldn't get a cook" was that she could have got a dozen good cooks if she had been willing to pay the market wages. In a real market, people who want goods can get them at the price prevailing; those who wish to sell can sell. At the price set, there can be no oversupply or undersupply of corn or wheat, of wheat straw or diamonds, of turnips or radium.

We are now in a position to graph changes in both demand and supply, which we have defined as schedules. Such a graph is shown in Fig. 12.

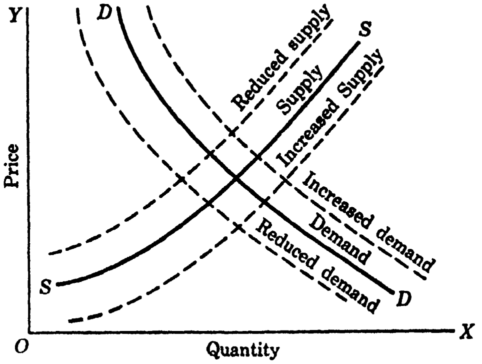


FIG. 12.

Relation of margins to market price

In any given market three classes of buyers and three classes of sellers are represented in the demand and supply schedules, respectively. The buyers include (1) *intra-marginal buyers,* who would have bought a certain number of units at higher prices but are buying

Amount Buyers Would Buy (In millions of Bushels)				Price per Bushel	Amount Sellers Would Sell (In millions of Bushels)			
Extra-marginal	Marginal	Intra-marginal	Total		Extra-marginal	Marginal	Intra-marginal	Total
14	30	106	150	$ .30			50	50
11	25	104	140	.40			60	60
8	20	102	130	.50			70	70
5	15	100	120	.60			80	80
3	10	97	110	.70			90	90
	5	95	*100*	*.80*		5	95	*100*
		90	90	.90	2	8	100	110
		80	80	1.00	4	11	105	120
		70	70	1.10	6	14	110	130
		60	60	1.20	8	17	115	140
		50	50	1.30	10	20	120	150

more "marginal" units at the price prevailing; (2) *marginal buyers,* who would buy no units at higher prices but are willing to buy a certain number at the price prevailing; and (3) *extra-marginal buyers,* who would buy only at prices lower than those prevailing. All three classes are included in the demand schedule, or curve. Similarly, the sellers include (1) *intra-marginal sellers,* who would have sold a certain number of units at lower prices but are selling more at the price prevailing; (2) *marginal sellers,* who would sell no units at lower prices but are willing to sell a certain number at the price prevailing; and (3) *extra-marginal sellers,* who would sell only at prices higher than those prevailing. All three classes are included in the supply schedule.

The demand and supply schedules for wheat shown on page 206 include these six classes; a graph of these schedules is shown in Fig. 13.

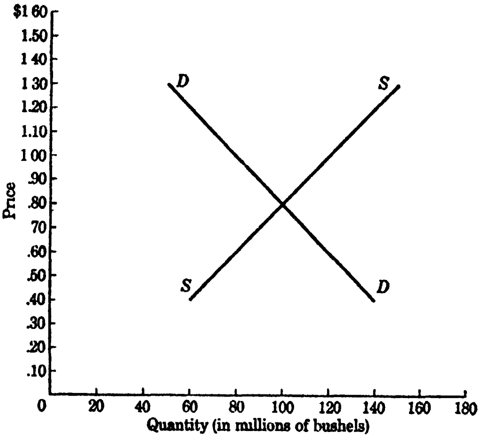


FIG. 13. Price Determination, Wheat.

The relation of marginal buyers and sellers, and of the marginal purchases and sales by intra-marginal buyers and sellers, to market price is a question about which economists are not in clear agreement. Many able economists seem to believe that these marginal purchases and sales have a particular significance in the price-fixing process because it is at the margin that changes occur in the amounts supplied and demanded when prices change. This appears to be an error, however. It is true that price changes affect the amounts bought and sold only at the margin—at 80 cents in the above schedule—and in any discussion of the *effect* of price changes we must give particular attention to the situation at the margin. If, for instance, a great many purchases are marginal, a small rise in the price will greatly reduce the amount purchased; and if many sales are marginal, a small decline in price will greatly reduce the amount offered on the market. But all this is indicated in the demand and supply schedules; moreover, this analysis does not relate to the *causes* that determine price, the real subject matter of this chapter, but to the *effects* of changes in price, and thus assumes the very changes in price which it is our task to explain.

Furthermore, the assumption that marginal buyers and sellers, or marginal purchases and sales, determine price involves circular reasoning; for if they determine price, the price no less certainly determines which purchases and sales are marginal. In the above schedules, for example, the intra-marginal buyers and sellers will buy and sell at every price. What is it that makes certain of their purchases and sales marginal? The fact that the price is fixed at that point. If the price were fixed at some other point, the purchases and sales would be marginal at that other point.

Joint products

Joint products present some serious difficulties in the problem of long-run price determination, as we shall see later, but their market price is not difficult to explain. By joint products we mean "*things which cannot easily be produced separately; but are joined in a common origin . . . such as beef and hides, or wheat and straw.*"[4] The market price of a joint product—beef, or hides, or cotton seed, or cotton fiber, for example—is determined by the general conditions of demand for and supply of the particular joint product. The amount of cotton seed produced, and therefore available in the market, is determined by past market conditions, not only for cotton seed but for cotton fiber; but in the analysis of market price we assume that a certain amount has been produced and that various amounts will be put on the market at various prices. The market price of cotton seed is therefore determined like that of any independent commodity, by demand and supply.

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[4] Alfred Marshall, *Principles of Economics,* p. 388. (Italics mine.)

Monopoly Market Price

Although careful discussion of monopoly price will be reserved for the chapter on long-run normal price, some consideration must be given to monopoly market price here. Monopoly has already been defined as control over supply or price, and it will be recalled that a producer has an element of monopoly power whenever he produces so large a proportion of the total supply that by offering or withholding his part of it he can affect the price appreciably. He can raise prices only by reducing supply, because generally he has no control over demand; and he can reduce the supply only by destroying part of it or by failing to put it on the market. The latter really represents nothing but a transfer of supply from one time to another if he finally puts it on the market.

A competitive producer can seldom if ever afford to destroy part of his supply. It is true that if there were only two or three sellers and if the demand for the product were extremely inelastic, one seller might destroy part of his supply and dispose of the remainder at a price enough higher to yield him a greater total return than he would have received from selling his entire supply.

This possibility may be shown by a graph, like that in Fig. 14. Let us assume only two competitive sellers of fodder, *A* and *B*, in a drought-stricken community where the demand for fodder is extremely inelastic. In order to simplify our problem we shall also assume that there is no cost of bringing the fodder into the market and that the sellers have no other use for it, thus eliminating the consideration of market price cost of production. If *A* and *B* sell all the fodder they have—*Oe* on the line *OX*—they will receive a price *Of*. If *B* destroys units *de*, the remaining supply will sell for *Og*. It is clear that while most of the gain goes to *A*, *B* will also gain, because the parallelogram *lhjd* is greater than *like*. The demand curve for a product seldom slopes as steeply as this, however. The competitive seller is practically always impelled to sell all his supply. If he destroyed any of it he would suffer *all* the loss in the amount supplied and would enjoy only part of the gain in price. As a rule, only a monopolist can afford to destroy part of his supply. The East India Company, which once controlled the supply of spices, is said to have done this at times; in recent years the Brazilian government has burned a part of the supply of coffee; and some of the California fruit producers have destroyed part of their crops by pouring kerosene over them or leaving them on the trees.

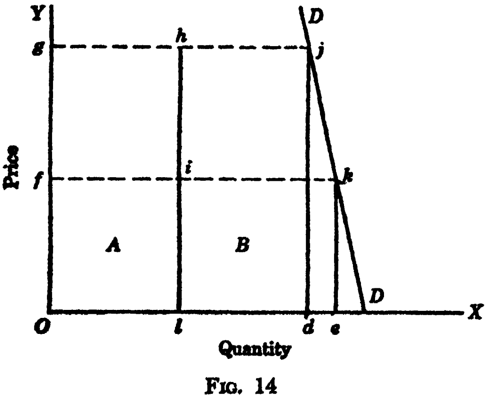


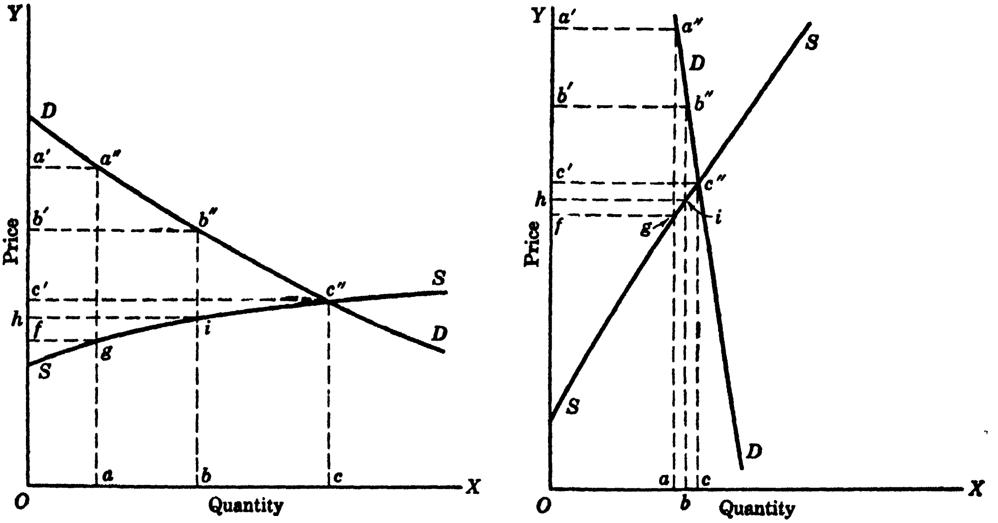
Fig. 14

The significance of monopoly control, the extent to which it may raise prices of various products, varies with the elasticity of demand and supply. If the demand for a product is very elastic, the monopolist cannot raise the price much without greatly reducing his sales; but if the demand is inelastic, he may raise the price a great deal and yet suffer only a small loss in sales. On the other hand, the more elastic the supply, that is, the more nearly horizontal the supply curve, the less will costs fall with reductions in sales—such small costs as must be met in getting the goods into the market. In graphing this situation, the supply curve is also a cost curve in this sense.

Fig. 15 is a graph of four of the various possible situations. In each case, the monopolist sells the amount that will yield him the greatest net revenue above the cost of getting the goods into the market; and in each case this depends on which of the parallelograms or areas is larger, $fa'a''g$ or $hb'b''i$, etc. The number of such possible areas is of course very great, and the number of possible prices is likewise very great; only three of them are indicated on the graphs. The monopolist chooses the price which will give him the largest area of net revenues. The important point is that the more elastic the demand and supply curves, the less incentive is there to restrict sales.

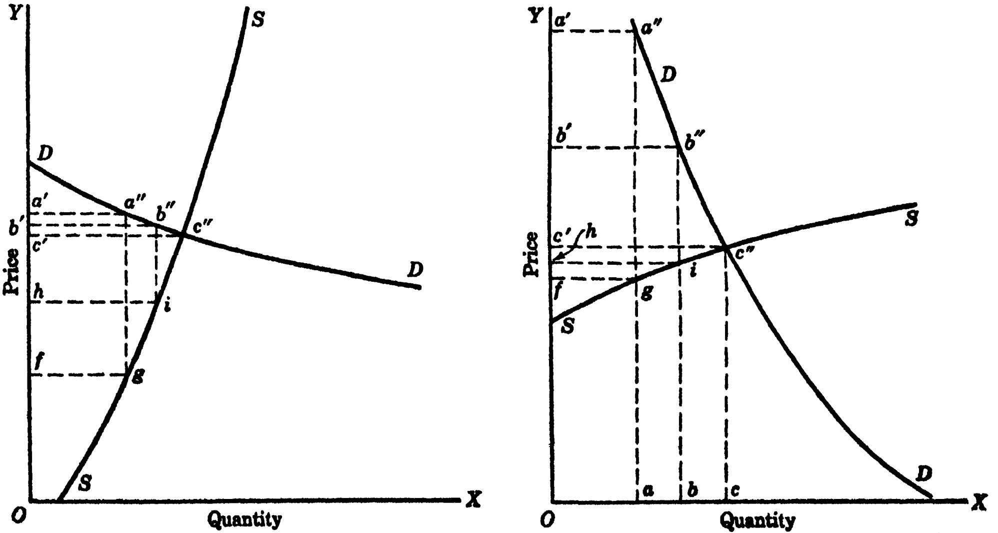
Monopoly and joint demand

We have seen that a joint demand is likely to be inelastic. If products that are jointly demanded are controlled by monopolies, their prices are likely to be kept high. This is true, for instance, in the building industry, for the various materials and labor needed are jointly demanded and to some degree monopoly-controlled, with each of the various monopolists trying to take advantage of the inelasticity of the demand. The producers of cement know that a considerable increase in its price will not raise the price of houses much, and therefore will not greatly reduce the amount of cement demanded; and the producers of plaster and lumber and copper and hardboard and



A. Elastic demand and elastic supply

B. Inelastic demand and inelastic supply



C. Elastic demand and inelastic supply

D. Inelastic demand and elastic supply

Fig. 15.

insulation materials and of many other things used in building assume that high prices for their products will not affect the amounts demanded very much. The building craftsmen, following the same line of reasoning, keep wages high. The theory is valid if only one or a few of the producers are trying to take advantage of the situation; but when all of them jack their prices up, the result is that the price of houses rises considerably, fewer houses are built, and the demand for each product used in building proves to be fairly elastic. Yet it would be unprofitable for the producer of any one material to reduce his price, because his action would reduce the price of houses very little and so would increase his sales very little. The law of joint demand operates to make houses very expensive.

Market price of natural resources

Interesting and significant illustrations of the principle of monopoly market price, and of public policy regarding monopoly control, may be seen in connection with some of our exhaustible natural resources. Not all natural resources are controlled by monopoly, to be sure, but some of them are. Exhaustible natural resources are excellent examples of supply, as we think of it in market price. They exist in a fixed amount, although the exact amount may not now be known; they are gifts of nature; and therefore—as *resources*, not as marketable products—the problem of cost of production does not enter, and their prices depend on the amount sold each year. It is true that to sell some of them will require many years; but since as resources in their natural state they have no cost of production and cannot be reproduced, their exploitation and sale represent the principle of market price rather than normal price. Each year or each month or each day, a certain part of the supply is marketed at a price determined by the amount put on the market, by the nature of the demand schedule, and by all the other factors affecting market price.

For a given amount sold, a monopolist can get no higher price than competing sellers could get, because he has no control over the demand schedule. He can raise prices only by putting less on the market. If, however, he feeds his resource into the market slowly, in order to raise the price, he will have more left to be sold in the future, and the future price will be lower. He knows that public opinion will not tolerate the deliberate destruction of any part of the supply, and hence is in a dilemma: the higher his price is now, the lower it must be in the future; and the lower it is now, the higher it must be in the future.

We might assume that, faced with such a dilemma, the monopolist will be indifferent as to whether his price is high or low now, since it will have to be reversed in the future, or that he will skimp the market now, and continue skimping it, thus getting a high price in the indefinite future. Just how much he will gain by such a policy depends on a number of factors, particularly on the elasticity of the demand for the product. If the elasticity is less than unity, he can of course increase his income by skimping his output, fixing it at the point where his total income will be greatest and keeping it there for the indefinite future. If the elasticity of the demand is greater than unity, however, he will have to sell his resource more rapidly in order to secure the maximum present income; but this will exhaust it sooner and shorten the period within which he will receive an income. To what extent can he afford to curtail his present sales at a sacrifice in annual income, in order to insure an income for a longer time?

The answer to this depends on the rate of interest. The monopolist has to discount all future incomes at the current rate of interest for the number of years that they are deferred; and the higher this rate is, the less will be their present "discounted" value, and the faster will he be induced to dump his resource on the market. Conversely, the lower the rate of interest, the greater will be the discounted value of future incomes, the more anxious will he be to receive them, and the more slowly will he sell his resource—which means, the higher will be the present price.

QUESTIONS

1. Define clearly the three different periods of time for which conditions of supply must be considered.
2. In the market price period, does the supply curve, say of watermelons in August, represent the total amounts in the *fields* or the amounts in *stores* and on *fruit stands?*
3. Graph the following schedules for oranges (per box):

Price	Amount Demanded	Amount Supplied
$1.00	1000	100
1.50	956	200
2.00	900	300
2.50	850	400
3.00	800	500
3.50	750	600
4.00	700	700
4.50	650	800
5.00	600	900
5.50	550	1000
6.00	500	1100

   What price is fixed in the market? Show by graph the situation if the government fixes a price of $6.00 for oranges.

4. When the housewife complains that she cannot get "help," exactly what does she mean? When the entrepreneur complains of a shortage of labor, what does he mean? Is there ever a shortage of labor in the sense that the supply is not equal to the demand? Is there ever a shortage of anything, in this sense?
5. "The important individuals in establishing the exact market price are the marginal buyers and sellers." Do you agree? Draw demand and supply curves showing where you would find the marginal buyers and sellers, and indicate their relation to price.
6. "The trouble during the war was that even in unrationed products the demand exceeded the supply." Do you agree? Explain.
7. Suppose that a government monopoly took over the business of exporting wheat; how much higher price could it get than 1000 competing exporters, if it does not reduce the amount exported?
8. "To say that price depends on demand and supply seems to be reasoning in a circle, since if price is affected by demand and supply, demand and supply are no less affected by price." Explain the error in this.
9. When the price of sugar was going up, during and after the First World War, people bought a great deal of sugar; when the price started down later, the amount demanded declined greatly. Is this a contradiction of the general law of demand?
10. What do considerations of the future have to do with the determination of present market price?
11. With a given change in demand, the more elastic the supply the greater will be the proportional change in the quantity exchanged. Illustrate by a graph.
12. What would be the effect of a rise in the price of corn on cattle prices in the market price period?
13. Define elasticity of demand. There is a strong demand for coal in winter and a weak demand in summer. Is this an illustration of elastic demand?
14. Assuming an inelastic demand for wheat, will a large crop sell for more or less than a small crop?
15. Exactly why is the demand for a product which is jointly demanded likely to be inelastic? Give examples.

16. If the elasticity of demand for a product is unity, how much will a monopoly produce and sell? Explain clearly.
17. If demand is doubled, will the price be doubled? Will the price be doubled if the supply is reduced 50 per cent? What effect will doubling the price have on demand? If the supply is doubled, what will be the effect on price? Draw graphs.
18. How does monetary inflation affect demand? How does a change in price affect demand?
19. Draw a series of graphs showing:
    (1) Increased demand with no change in supply, (a) supply elastic; (b) supply inelastic.
    (2) Reduced demand, (a) supply elastic; (b) supply inelastic.
    (3) Increased supply with no change in demand.
    (4) Increased supply and reduced demand.
    (5) Both demand and supply increased.
    (6) Both demand and supply reduced.
20. Will doubling the supply of all commodities alter their relative prices? Explain.

Chapter 15.

Short-run Normal Price: The Intermediate Period

Price in the intermediate period

We turn now to the consideration of price in the intermediate period, a period long enough to permit some changes in the supply through more or less intensive use of the existing plant, but too short to permit changes in the plant itself, and therefore too short to permit complete adjustment to costs of production. It is the period intermediate between the market price period, in which costs of production play little part, and the long-run normal period, in which all costs of production must be covered.

Market price, it will be remembered, must be at least high enough to cover two costs: (1) getting the product to the market, and (2) foregoing other uses of it. Short-run normal price must also cover these costs, and in addition the variable costs of production, but not necessarily fixed costs such as interest on plant investment. Thus, in the case of the apples referred to in an earlier chapter, the short-run normal price must cover not only the costs of bringing them to the market and foregoing other uses of them, but also the costs of the labor used in cultivating and spraying the trees, of the fertilizer used on the land, and other variable expenses. The supply curve in this period covers more kinds of costs than the market price supply curve, but it resembles the latter, although it is generally more elastic; and price is again determined by the equilibrium of supply and demand.

The four cost curves

It will be well now to turn to the situation of the individual producer in the intermediate period. Although the period is too short to permit expansion of plant, he can expand or contract his output to some extent without altering his plant; and in doing so he must consider four different kinds of costs. As graphed in Fig. 16, these four costs are: average variable costs (*AVC*), average fixed costs (*AFC*), marginal costs (*MC*), and average total unit costs (*ATUC*). It is assumed that this producer has

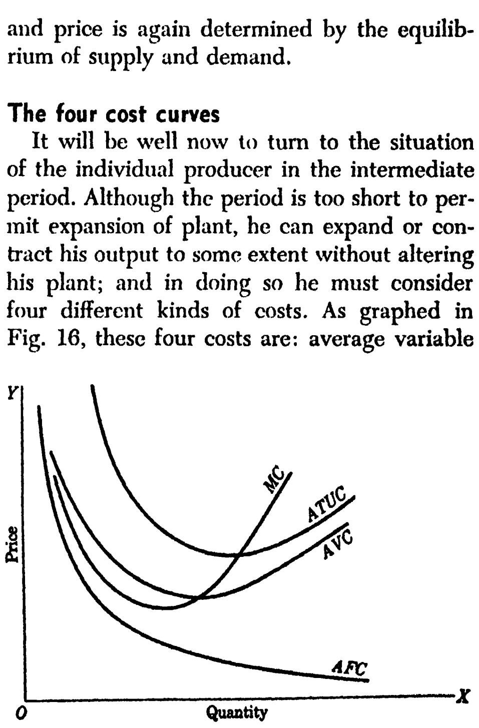


FIG. 16.

a given investment in plant and equipment, and that he expands production along line *OX*, variations in costs being measured upward from this line along line *OY*. We now proceed to an explanation of each type of cost.

The *total fixed costs,* as of *plant, durable machinery, and managerial staff,* do not change at all as output expands. The total interest charge on the investment in plant and durable machinery, for example, is the same no matter how intensively the plant is used, which means that the *average fixed costs* (*AFC*)—the fixed costs *per unit*—decline as the output increases, and in inverse ratio to this increase. That is, if output is doubled, the fixed costs *per unit* are reduced one-half; and if output is quadrupled, the fixed costs are reduced three-fourths. Thus, since total fixed costs do not increase with increased output, or, to put it another way, since fixed costs *per unit* of output decline steadily, this is a factor that induces entrepreneurs to expand output; and the heavier the fixed costs, the greater the inducement to increase output. Since total fixed costs do not change with changes in output, their curve, when graphed, is a rectangular hyperbola. Lines drawn from all points on the curve of average fixed costs horizontally to the left and perpendicularly downward—from *AFC* to *OY* and *OX*—define equal areas.

Average variable costs, as of *labor and raw materials,* vary directly with the amount of output, but seldom at the same rate as output. Variable costs per unit of output will ordinarily be very high, for instance, if the plant is producing only a small proportion of its potential output, because the small force of laborers required will not be able to secure some of the advantages of specialization. Expansion of the small output will bring declining average variable costs until the lowest point is reached. From that point on, variable costs per unit of output, *AVC,* will rise rather sharply as more and more laborers are crowded into the plant, as night shifts are added, and as the plant is used more intensively in other ways.

Total costs are *the sum of the variable and fixed costs.* Since fixed costs per unit of product decline very steeply at first, and average variable costs somewhat less steeply, the curve of average total unit costs (*ATUC*) at first slopes downward less steeply than the curve of average fixed costs (*AFC*) and more steeply than the curve of average variable costs (*AVC*).

Marginal costs represent *the addition to total costs due to additional units of output.* If, for instance, a manufacturer of tractors has been producing 1000 machines a month at a cost of $1,000,000, and if the addition of one tractor per month to his output adds $1005 to his total costs, then $1005 represents marginal costs. Or, since a tractor manufacturer would hardly figure in terms of a single tractor, perhaps a more realistic hypothesis would be that of adding to his output an "increment" of a number of tractors, say 50 a month. If these additional 50 tractors a month increase his total costs by $55,000, then his marginal costs will be $55,000 for the "uncrement," or $1100 for each tractor added.

We are assuming here that the producer does not enlarge his plant or his managerial staff, and that therefore there is no increase in the total fixed costs with the addition of the marginal units of output. Marginal costs are thus dependent entirely on variable costs. They do not represent the *total* costs of producing the last unit of output, but only *the addition to total costs,* which, since total fixed costs do not increase at all, means the addition to variable costs. The marginal cost curve (*MC* in Fig. 16) presents a graphic picture of the changes in total costs as the producer, with a given amount in plant and equipment, expands production along the line *OX*.

The concept of marginal costs may seem unreal to the student, because we do not see most firms gradually building up production in the way indicated here; yet many concerns actually do something like this. For example, a businessman entering into the manufacture of pop in a fair-sized town is likely to build or buy a plant large enough to produce the output which he hopes finally to be able to sell; but he cannot achieve this output immediately. He will have to content himself with a small output until he can build up his sales outlets; and during this time his costs—marginal, average variable, and average total—will be high. Indeed he will almost certainly lose money for a while, and he will therefore have to have financial reserves to cover his losses until he can increase his output up to the point where he can earn average total costs. Many merchants who start business this way may have to operate at a loss for several years—at a loss, at any rate, in the sense that they earn less than reasonable wages of management. At any given time, particularly if business conditions are changing, most producers are likely to be doing just what the marginal cost curve suggests—adding or subtracting units of output from time to time, with resulting changes in marginal costs.

We have defined marginal costs as the addition to total costs due to the additional units of output, and this is the sense in which the term will be used in this chapter; but it is sometimes used in another sense, to mean the costs of the marginal producer, who makes no profits and is barely able to operate under prevailing conditions. The marginal producer and the marginal output of the intra-marginal producer both represent margins at which the output may change with changing conditions of demand or costs. An increased demand for milk, for instance, is likely to make a different producer marginal, and bring a change in the marginal product of the more efficient producer. The producer who was marginal at the lower price will no longer be marginal but will now be making a profit; a new producer, with higher costs, will now represent the marginal producer; and all the producers, in the short-run normal period, will tend to expand output. On the other hand, if the price declines, the marginal producer is likely to be forced out, because he was barely making expenses before; and all the producers will tend to restrict their output.

To return to Fig. 16, we see that the marginal cost curve, *MC*, declines as output is increased, and then rises, to cut both the average variable cost curve, *AVC*, and the average total unit cost curve, *ATUC*, at their lowest points. Why does it cut both curves at the lowest point? Because as long as marginal costs, ***the addition to total costs due to additional units of output***, is less than average costs, the addition of the marginal unit to the total output will reduce average costs. This means that the *AVC* and *ATUC* curves must slope downward as long as the *MC* curve is below them; when the *MC* curve is above them—when the cost involved in adding another unit of product is higher than the average cost, variable or total—the *AVC* and *ATUC* curves must slope upward because the addition of the marginal unit raises average costs. Therefore the *MC* curve obviously has to cross them at their lowest points. Once the *MC* curve has crossed them, it must rise faster than either of them, because marginal costs are the addition to total costs made necessary by producing the last or marginal unit, whereas average variable and average total costs represent an average of costs—the high cost of this last unit and the cost of other units produced at lower costs.

Another feature of Fig. 16 must be noted. The *ATUC* curve reaches its lowest point to the right of the lowest point on the *AVC* curve. Why is this? It is because total costs include fixed as well as variable costs; and the curve of average fixed costs, *AFC*, to the right of the line *OY*, crowds the *ATUC* curve to the right of the *AVC* curve. Stated another way, the curve of fixed costs per unit of output declines indefinitely as output is increased; and even after average variable costs have reached their lowest point and started gradually upward, the continued decline in the *AFC* curve will for a while overbalance the rise in the *AVC* curve, to fix the lowest point on the *ATUC* curve somewhat to the right of the lowest point on the *AVC* curve.

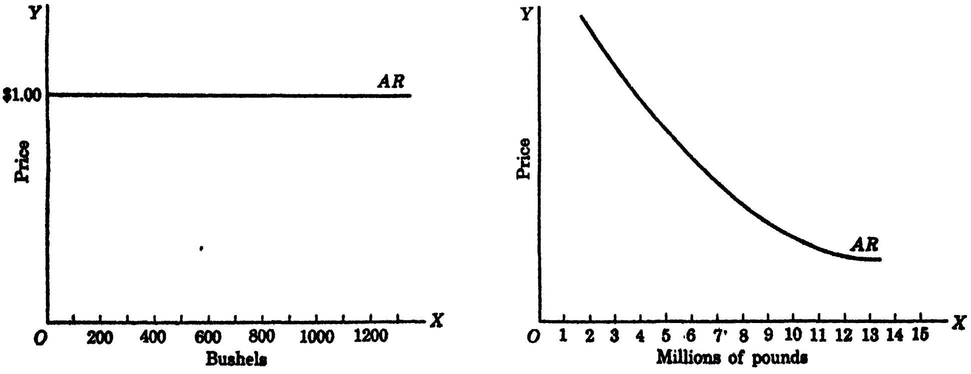
Average and marginal revenue

Turning now to the income or revenue of the individual firm as it expands output in a fixed plant, we must distinguish between *average revenue* and *marginal revenue*. Average revenue is the *average price received for the various possible outputs*. In wheat production, a purely competitive industry, the price or average revenue received by any individual farmer is the same, no matter how much he puts on the market, because he produces only an infinitesimal part of the total supply. If the price of wheat, as fixed not by the individual producer but by the broad forces of demand and supply, is $1.00 a bushel, the individual farmer can sell one bushel or 10,000 bushels at $1.00 a bushel, but he can sell none at even half a cent more. His price or average revenue is $1.00 for all amounts; drawn as a curve, his average revenue is a horizontal line (Fig. 17). A monopolist or monopolistic competitor, on the other hand, selling, let us say, aluminum or Rice Krispies, faces a declining price or average revenue curve as he expands production and sales, *because he produces all of his particular commodity that is produced.* His average revenue curve is the aggregate demand curve for his commodity; and, like all demand curves, it declines as the amount sold increases. In this respect it differs from the average revenue curve of the individual wheat producer.

Marginal revenue, which corresponds to marginal costs, represents *the addition to total revenue due to additional units of sales.* For the (practically) purely competitive producer of wheat, marginal revenue is the same as average revenue. We have assumed that our wheat producer's average revenue—the average price he receives—is $1.00 a bushel, no matter how much he sells. His marginal revenue—the amount added to his *total* revenue—is also $1.00, regardless of the quantity he sells. Hence the horizontal line *AR*, in Fig. 17, is both the average and the marginal revenue curve.

For the monopolist or the monopolistic competitor, as for the purely competitive producer, marginal revenue is defined as *the addition to total revenue due to additional units of sales,* but it is not identical with average revenue. When our wheat farmer sells an additional unit of wheat, he sells at the same price that he received for other units. The average revenue —price—is $1.00 for all bushels sold, and every bushel sold adds $1.00 to his total revenues. When a monopolist or a monopolistic competitor sells an additional unit of output, he not only must sell the *additional unit* at a lower price, but must reduce the price of *all units sold.* The amount he receives for the last unit—the sale price of the last unit—is not his marginal revenue (the amount added to his total revenue), because he must deduct the loss due to the reduction in the price of his entire output.

To illustrate this, let us suppose that the Aluminum Company of America has been producing and selling 1000 tons of aluminum per week at $200 a ton, for a total gross revenue of $200,000, and that it adds a unit of 100 tons a week and cuts the price to $190 a ton to dispose of the enlarged output. The average revenue per ton is now $190, or, per unit of 100 tons, $19,000; but this is not the marginal revenue because the company has to reduce the price on the other 1000 tons from $200 to $190, thus losing $10,000. It must subtract this loss from the sale price of the last unit, $19,000, to get the marginal revenue, which is $9000. Or, since marginal revenue is the addition to total revenue due to additional units of sales, it may be computed by figuring the total gross revenue before and after the last unit was added—$200,000 and $209,000, in the above case. As Fig. 18 shows, the marginal revenue curve of a monopolist declines



Average revenue curve of individual wheat producer, as additional bushels are sold

Average revenue curve of monopolistic or monopolistically competitive producer

FIG. 17.

more steeply to the right than his average revenue curve.

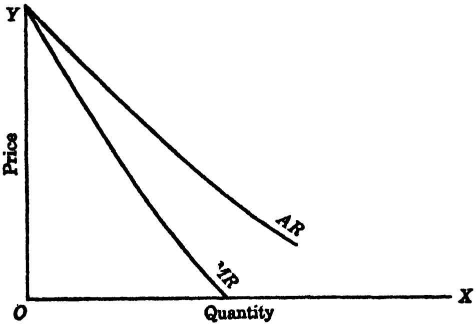


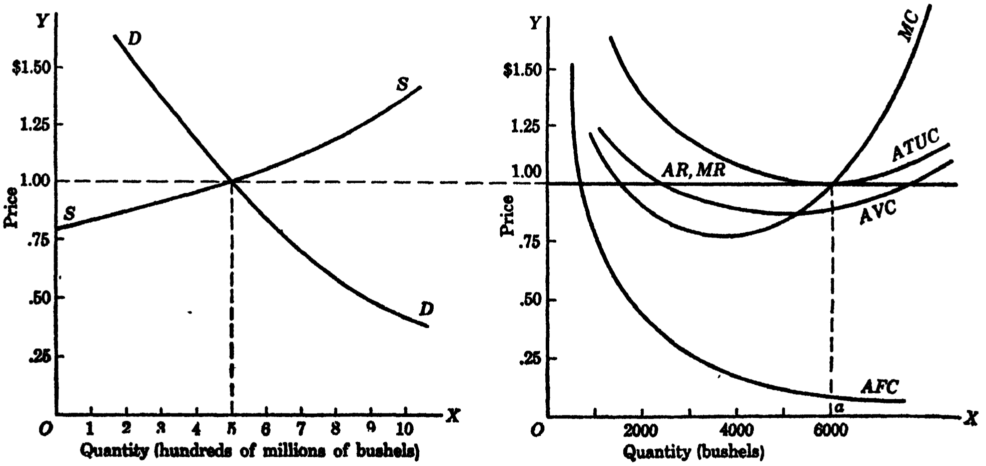
Fig. 18.

Cost and revenue curves combined, in competition

Putting cost and revenue curves together, we see, in a purely competitive industry, the process not of price determination but of *adjustment to* the price that is fixed by the broad conditions of aggregate demand and supply in the industry as a whole. The individual wheat farmer has practically nothing to do with determining the price of wheat; he merely adjusts his operations to that price. This is shown graphically in Fig. 19.

Here we have the curves of aggregate demand and supply fixing a price of $1.00 a bushel for wheat, and the individual producer adjusting his operations to this price and producing 6000 bushels at an average total unit cost of $1.00 a bushel, which is the lowest cost possible for him. He is earning neither profits nor losses, and his situation is therefore the same as it would be in the long-run normal period. This is only one of many situations possible in the intermediate period, for in this period he might be earning profits or losing money. He must, however, earn enough to cover his average variable costs, for if he does not he will do well to abandon farming.

Taking this graph as drawn, but remembering that it might have been drawn in any one of a hundred different ways, we may ask why the farmer expands output to the point of lowest average total unit costs. This may be explained in two ways. First, at this point marginal costs rise to the level of marginal revenue. It will be remembered that the *MC* curve always crosses the *ATUC* curve at its lowest point. Up to this point, increased output adds more to revenue than to costs; beyond this point increased output would add more to costs than to revenue and would therefore result in a loss to the producer. Second, with the curves drawn as in Fig. 19, it is clear that only at point *a*, with output of 6000 bushels, can the farmer cover his average total unit costs, because the *ATUC* curve is above the *AR* curve for any output smaller or larger than this.



A. Demand and supply curves determine price

B. Adjustment of individual producer's output to price

Fig. 19.

Cost and revenue curves in monopoly and competitive monopoly

In the case of monopoly and competitive monopoly the determination of output and price is quite different. The monopolist or the monopolistic competitive producer produces the total output; and therefore the average revenue curve, which is also the aggregate demand curve for the product, slopes downward to the right and the marginal revenue curve slopes downward even more steeply. Output and price are determined by conditions *within the firm,* because the firm produces the entire output of the product. As in pure competition, the producer expands output to the point where marginal costs equal marginal revenue —expands output as long as additional units add more to revenue than to costs—point *a* in Fig. 20. The price at which he sells is the average revenue for that output. His profit is represented by the area *gefh,* since the *ATUC* curve is below the *AR* curve by the distance *hf.*

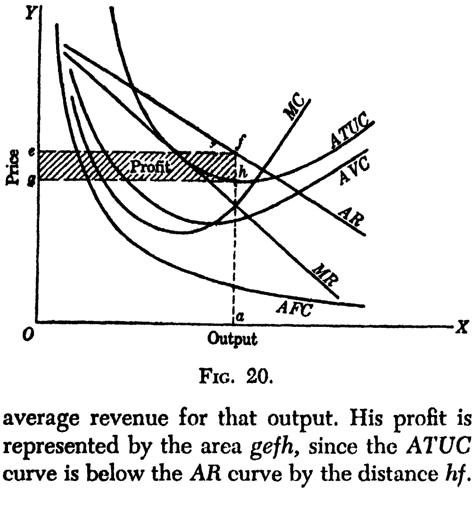


Fig. 20.

Intermediate price and average variable costs

Intermediate price must cover at least average variable costs. Marshall defines intermediate price, for any given daily catch in the fishing trade, as "the price which will *quickly* call into the fishing trade capital and labour enough to obtain that supply in a day's fishing of average good fortune."[1] Although the price he refers to here is above the long-run normal price, it may also be below it. It must be high enough so that the producer will lose nothing, at least directly, by continuing to operate his business, or, better, so that he will lose no more by continuing than he will by closing up. If he is making little or no return on his investment in plant, his fixed costs, he is losing; but if he is making enough to cover his variable expenses and wages of management, he will not benefit by closing up shop.

General conclusions here are all subject to various exceptions. However low prices may be and however unprofitable business may be at any given time, the producer is likely to be guided to some extent by his judgment of future conditions; and if he has some financial reserves and believes that conditions are likely to improve, he may continue to operate for a considerable time even though his revenues do not pay variable costs or wages of management. To close up for a while would mean dismissing a labor force which it would take some time to rebuild later, and he might lose valuable business connections and good will which could be regained later only at some expense. Even if he is making enough to cover all his variable costs and wages of management, he may close up, perhaps even abandon his business, if he can see no chance of future improvement.

Usually, however, his choice is not between operating and not operating, but between producing a little more or a little less. If his plant is not operating at full capacity, he may well accept additional business and increase production somewhat, even at a price which covers only the costs of labor and raw materials and a little for the wear and tear of his machinery. Deterioration proceeds even when machinery stands idle. Since he will want to keep his managerial staff together, he might allow very little for the extra work of management in increasing production a little.

It must not be assumed that there is any precise line distinguishing variable from fixed costs. The costs of the leather and labor used in a shoe factory are clearly variable costs, and the charges against the factory itself and some of the durable equipment clearly represent fixed costs; but what of the cost of a truck which may be bought and sold at any time, or of the needles used in sewing, some of which may not last more than a few days or weeks?

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[1] Alfred Marshall, *Principles of Economics,* p. 370.

Wages of common labor represent variable costs, and the salaries of the managerial staff represent fixed costs; but how far down the line does the managerial staff extend—to foremen, subforemen, technicians, accountants, and salesmen? The line cannot be drawn precisely; but with this warning we must use these terms as if they meant something definite.

Intermediate price in time of war

Intermediate price may be either above or below long-run normal price. It is likely to be above if a sudden increase in demand forces the price above the level necessary to pay the interest and depreciation charges against the fixed plant. During the Second World War, for instance, the imperious demand for munitions forced the prices of munitions so high that many industrial plants were turned over to their production and ran at maximum capacity. In various ways this meant high costs. Some plants were not modern, even for normal use; some machinery had to be converted; some new machines and equipment, produced at high cost in the emergency, had to be installed; and all the machinery had to be operated at maximum speed and capacity. Some laborers received extremely high wages for overtime and night work, and relatively inefficient workmen were pressed into service at regular wage rates. New administrative, technical, and accounting staffs had to be organized, some of them not very efficient but nevertheless demanding high salaries. Thus a great many factors pushed costs far above the long-run normal level. If the situation had seemed likely to persist for many years, new plants would have been built, additional machinery would have been installed, and labor, enticed by the high pay, would have flowed into the industry and forced wages down; but since the situation seemed likely to last only a few years, these adjustments were not made and costs and prices remained high throughout the war.

Intermediate price below long-run normal price

Intermediate price is more likely to be below long-run normal price than above it. In case of a great increase in demand, the intermediate price can remain above long-run normal only long enough for old plants to be enlarged, new ones built and equipped, and managerial staffs organized, provided that there is no monopoly and no natural obstacle to such expansion and the increased demand is likely to last long enough to justify the investment in new plant. If the demand declines, however, it may require many years for the existing plants to shift out of production, through the slow process of depreciation and obsolescence.

Intermediate price in a monopolized industry

The railroad business provides a good example of the adjustment of a monopolized industry to lower revenues through the short run to the long run. The railroads were built originally with the expectation that they would earn at least operating expenses, depreciation, and interest charges on the amount invested in the physical plant and equipment. For various reasons, particularly the appearance of truck, bus, automobile, and airplane competition, many railroads have been earning little or nothing on their fixed costs. Obviously this is an unstable situation, but it may prevail for some time in this particular industry.

First let us assume that a railroad earns enough to pay operating expenses (variable costs) but nothing more, not even the salaries of the managerial staff, which are included in fixed costs. It is evident that it must be scrapped, for it will operate at a direct loss.

Suppose, however, that the railroad earns enough to cover operating expenses and managerial salaries, but nothing for upkeep or depreciation or interest on the investment in plant. In this case, there is no reason why the owners should keep it in operation, unless they themselves are managing it and earning the managerial salaries; but if they wish to, they can keep it going as long as it will operate without repairs. When the equipment begins to break down, the railroad must be scrapped.

Suppose, now, that the railroad revenues are enough to cover operating expenses (variable costs), wages of management, and upkeep and depreciation on all its plant and equipment, but nothing more. The railroad may continue to operate indefinitely if the owners wish to keep it going. However, they will probably abandon it because they make nothing on their investment if they run it, and if they pocket the upkeep and depreciation funds and let the road gradually wear out, they will salvage at least a little from the enterprise; or they may pocket only part of the upkeep and depreciation funds, putting the balance into upkeep and thus prolonging the life of the railroad in order to receive an income a little longer. How much of the receipts they keep for themselves and how much they use for repairs and upkeep will depend upon their calculation of all the possible incomes, present and future, that they would receive under the alternative policies, future incomes being discounted at the current rate of interest. The more they put back into repairs and upkeep, the smaller will be the amounts they are able to keep, but the longer will be the time during which they will receive them. If they think there is a chance that the business may revive eventually, they may try to keep the plant and equipment in good condition, even if it means a present loss to themselves; but if the business does not revive, they will abandon it.

Let us suppose, finally, that the receipts are sufficient to pay the operating expenses, salaries of the managerial staff, repairs, upkeep, and depreciation costs, and something on the investment in the plant. In this case the owners will probably continue to operate the railroad for a long time, but not necessarily indefinitely. If the earnings on the investment are very small, the owners may decide that they can salvage more by pocketing part of the funds for repair and upkeep and letting the plant and equipment run slowly down into uselessness. By so doing they will get a larger income, but for a shorter time. The smaller the return they receive on their investment, and the larger the upkeep and depreciation costs, the more likely they are to do this.

Owing to the corporate structure of our railroads, the actual situation is somewhat different from this; but the future of some of them depends upon some such principle as has been outlined here.

QUESTIONS

1. Market price is price in a period too short for the total amount of the product *in existence* to be changed. In the intermediate period, how much change in supply is possible? Indicate what the intermediate period might be in the production of apples, wheat, cotton sheeting, timber.
2. The monopolist expands production to the point where (?) equals (?). Is this also true of the purely competitive producer? Draw two graphs to show this situation, one for pure competition and one for monopoly.
3. "Marginal costs are entirely dependent on average variable costs." Why?
4. When output has reached the point where marginal costs equal marginal revenue, has the individual firm reached *long-run* equilibrium?
5. "As long as average revenue remains constant with increasing output, marginal revenue and average revenue will coincide; but when average revenue declines with increasing output, marginal revenue must inevitably decline even more rapidly." Explain why.
6. Why does an increase in fixed costs tend to increase the amount of output along the *X* axis? Give illustrations of this tendency in agricultural production.
7. Why must the marginal cost curve cut both the average variable cost and the average total unit cost curves at the lowest point? Why is the lowest point of the average total unit cost curve to the right of the lowest point of the average variable cost curve?
8. Why do all the curves except the fixed cost curve decline for a while and then rise?
9. What are some of the elements in variable costs?
10. Marginal cost is used in two different senses. Explain.
11. Draw a graph to show the adjustment in output of an individual wheat producer to a rise in the price of wheat.
12. An economy in which there are much monopoly and monopolistic competition is likely to be a "scarcity system." Why? Do you therefore expect that we shall have maximum production and full employment for the indefinite future?

13. In wartime, some factories operate night and day. In what ways may this result in high marginal and average total costs? What effect has it on fixed costs per unit? Does a war situation represent the market price, short-run normal, or long-run normal period?
14. With the rise in the production of airplanes, tanks, guns, and shells during World War II, unit costs declined, in some cases as much as 50 per cent. What factors tended to reduce these costs as production increased, and what factors tended to raise them? Draw a graph showing the changes in costs, using the four cost curves.
15. In the intermediate period, what will be the effect of an increase in the demand for dressed poultry on the price of eggs? What will be the long-run normal effect?

Chapter 16.

Long-run Normal Price: Competitive

Long-run normal price defined

In the intermediate period, the period midway between the market price period and the long-run normal period, we found that the price must be at least high enough to cover variable costs, but not necessarily high enough to cover fixed costs too, although it *might* be much higher than this. We come now to long-run normal price, which, in a purely competitive economy, must cover *all* costs, including such fixed costs as interest, depreciation and upkeep on the fixed plant, and the salaries of the managerial staff. In the market price period we gave most of our attention to demand, for the supply was assumed to be in existence and costs of production therefore called for little consideration; in the intermediate period we devoted somewhat more attention to costs, but this period is too short to permit price to become fully adjusted to cost of production. In long-run normal price, which is the price toward which the intermediate price constantly tends, we shall find it necessary to devote most of our attention to costs of production, which govern the supply. There is no sharp line separating the three periods, but we can follow Marshall's general principle: "*As a general rule,* the shorter the period which we are considering, the greater must be the share of our attention which is given to the influence of demand on value [price]; and the longer the period, the more important will be the influence of cost of production on value. For the influence of changes in cost of production takes as a rule a longer time to work itself out than does the influence of changes in demand."[1]

In all periods, price represents an equilibrium between two opposing forces: between human wants on the one hand, and, on the other, resistance to the satisfaction of those wants in the form of costs of production in one form or another. In discussing Robinson Crusoe and the berries, we saw that he picked berries until he reached an equilibrium between their utility and the disutility of his labor. In market price we have an equilibrium between demand and supply, supply being a schedule of the prices necessary to induce holders to put their various portions of the supply on the market. Price in the intermediate period, as we have seen, represents the equilibrium between demand and, to some extent, costs of production, costs of production for this period being not necessarily all costs, but at least the costs of the variable agents. In long-run normal price, we shall study the equilibrium between demand and full costs of production. Because demand in this period is much the same as in the shorter periods, our attention will be given mainly to costs of production; but it must be remembered that price is always the result of the interaction of the demand and costs, in one form or another. Both demand and supply are essential to price determination, just as both blades of the scissors are essential to cutting, to use Marshall's well-known analogy.

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[1] Alfred Marshall, *Principles of Economics,* p. 349.

In the chapters on market price and short-run normal price, we discussed both competitive and monopoly conditions; but the analysis of long-run normal price calls for separate chapters for each situation. Accordingly, the present chapter discusses competitive price, and in the following chapter monopoly price is considered.

Long-run normal price, or simply *normal price*, the term used by most economists, is defined by Marshall as "the average value which economic forces would bring about if the general conditions of life were stationary for a run of time long enough to enable them all to work out their full effect."[2] Using an illustration from the cotton manufacturing industry, we might say that it is the price which would be set if all the following factors—the population, the supply of raw cotton, the labor supply, the efficiency and wages of laborers in the mills, the rate of interest on debts, the cost of fuel and power and taxes, public tastes, and the demand for cotton goods—remained stationary for a long enough period for unprofitable plant and machinery to be eliminated or necessary new plant and machinery to be built, for inefficient producers who are not covering expenses to be weeded out, and for the more efficient producers to adjust production to the point of lowest costs. In other words, it is the price which would be reached if all economic forces operated with absolute promptness and without any economic friction or inertia; if, for instance, all unprofitable plant and machinery, all producers operating at a loss, all productive facilities that will *ultimately* have to be eliminated were eliminated *immediately;* if all new plant and machinery and new producers that will *ultimately* enter the industry—under the conditions prevailing—were to enter *immediately;* and if all producers were to adjust production at the point of lowest cost without delay.

Long-run price a hypothetical price

Thus it may be said that long-run normal price is a hypothetical price, since in a dynamic, changing society we seldom or never see it. In a sense it is like the level which the water in the ocean seeks and would reach if there were no winds, tides, or other disturbing forces to prevent it. It is the price toward which short-run normal price is constantly tending but never holds for long, because conditions change before the forces "work out their full effect"; then the short-run normal price starts toward a new normal level, which again it fails to hold permanently because of further changes in conditions.

Perhaps someone will ask, Why study such an abstraction? The answer is that the study of long-run normal price is the study of tendencies, of fundamental forces that are constantly at work. Since the time of Adam Smith, economists have properly devoted most of their attention to normal price rather than market price, the latter being assumed to be a rather simple and superficial problem.

Meaning of cost

Following Marshall's statement that the longer the period the more important will be the influence of cost of production on price, we shall devote most of our attention to the problem of costs; hence our first task is to define the term costs.

Marshall makes a distinction between psychological "costs" or sacrifices, and money "expenses" of production. For some purposes this distinction is useful, but it will not be followed generally in this book. Fundamentally, all costs are psychological rather than monetary. In this sense, the costs of producing a commodity are "the exertions of all the different kinds of labour that are directly or indirectly involved in making it; together with the abstinences or rather the waitings required for saving the capital used in making it."[3] These costs or "discommodities" of labor and saving furnish the resistance to the satisfaction of human wants as represented by the demand.

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[2] *Ibid.*, p. 347.

[3] *Ibid.*, pp. 338–339.

The psychological aspect of costs may be best illustrated by our earlier example from primitive life. The savage who wanted a spear point was obliged to save enough food to last him a day or two, and then live on his savings while he labored at the spear point. His savings and his labor were the "costs" of his spear point. In modern life the process, although much more complicated, is the same in essence. In order that society may have shoes, it must pay not only for the labor used directly in making the shoes, but for the labor employed in raising the animals on the farm, in slaughtering the animals, in tanning the leather, in shipping the shoes from the factory to the retail store, and finally in selling the shoes to the consumer; in addition, it must pay for the labor used in making the shoe machinery, for the labor employed in making the machines used in manufacturing the shoe machinery—in short, for all the labor directly or indirectly used in the production of the shoes. And it must pay all these various kinds of labor as much as they could get in competing lines of work.

Society must pay too for the saving, or waiting, or abstinence involved in the creation of all wealth, for labor alone could not have created the machinery and other capital used in the manufacture of shoes. Some people must have saved—that is, consumed less than they produced—in order that the plant and machinery could be created; and these people must likewise be paid for their sacrifice. The amounts paid for the marginal labor and saving must be enough to compensate the laborers and savers for their sacrifice, and in a competitive society they cannot be much more than this; therefore we may assume that the money expenses measure the marginal psychological sacrifices with reasonable accuracy. The amount that must be paid to secure the marginal labor and savings is called the *supply price* of the labor and savings.

From the broad social point of view, land is the gifts of nature, and rent is therefore not a cost of production; but from the point of view of the individual producer, rent is a cost, quite like wages and interest. The individual farmer, merchant, or manufacturer must pay rent, or, if he owns his land, must make an allowance for it as "implicit" rent in figuring his costs. He must have saved in order to get the money with which to buy the land, just as he must have saved to buy capital.

Long-run normal price and profits

The relation of long-run competitive price to profits also demands brief consideration here. Profits, as we shall use the term in this book, refers generally to the total amount earned by the entrepreneur, the amount by which his receipts exceed his expenditures for rent, wages, and interest; but a distinction must be made between his *wages of management,* and *pure profits,* the latter representing anything earned in excess of the amount required to compensate him for his services as manager. Long-run competitive price must cover wages of management, just as it must cover wages of the lower grades of labor. Some entrepreneurs will earn more and others less; but entrepreneurs in general must receive wages of management in the long run or they will shift out of the industry. Hence wages of management must be included in costs of production and in long-run competitive price. It is not necessary that price include anything above this, however; in fact, *pure* profits tend to disappear in the long run, in competitive industries. If there are pure profits in an industry in the short-run normal or intermediate period, entrepreneurs will shift into that industry until increased competition reduces the price to a level at which only wages of management are earned. Illustrations of this process can be seen in industry at all times.

Opportunity cost

The cost of *any* factor of production used in a given line of production is an *opportunity cost;* that is, it is a cost set by other "opportunities" bidding for the use of that factor. A farmer raising wheat must pay enough for the use of the land to get it away from corn or cotton production; for labor he must pay a wage determined not by wheat producers alone, but by all the entrepreneurs who offer that particular type of labor an opportunity for employment. The cost of the capital he uses is determined by the total demand for and supply of capital. In wheat production, as in business generally, the principle of opportunity cost applies even to the income of entrepreneurs, for theoretically they must earn about as much in wheat production as in other lines that demand equal ability. If all the factors involved were well standardized and mobile, and if the conditions in the market were everywhere well known—in other words, if the conditions of a "perfect market" prevailed—the adjustment would be prompt and precise, and wages, interest, and profits would be the same in all fields of enterprise; but friction, inertia, and ignorance of conditions may prevent such adjustment, for the economic mill often "grinds exceeding coarse," and sometimes exceeding slow.

The cost of marketing

Production costs include not only the costs of growing or manufacturing physical commodities, but the costs of marketing; for marketing is as truly a productive service, quite as essential a link in the productive process, as the growing or manufacture of goods. As production is expanded, marketing costs may follow a different trend from manufacturing costs. Manufacturing costs may be declining as output increases, and marketing costs be rising; or the reverse may be true. Breaking up marketing costs into their several elements of hauling, storing, handing over the counter, and advertising, we may find that some of these elements follow one trend in costs, and others another. It is true that in a perfectly competitive market there is no need for advertising or salesmanship to create a demand *for the goods of any one producer over those of other producers,* because in such a market the goods are standardized, practically identical, and known to be so. But each agricultural product is different from other products; and the organized producers of a product—oranges, or raisins, or butter, for instance—may advertise in an effort to raise the demand *for their product over that for other products.* This element in marketing costs does not decline indefinitely; on the contrary, it may rise while manufacturing costs are still subject to decreasing or constant costs, because as more and more units are sold to more and more indifferent buyers, or to the same buyers to satisfy less and less intense wants, the marginal cost of selling necessarily rises.

Increasing, constant, and decreasing cost

Costs, or expenses, of producing different commodities vary with the amount of output; for some commodities they rise as production increases; for others, they change very little; and for still others, they decline. To put this in economic language, some commodities are produced at *increasing cost,* some at *constant cost,* and still others at *decreasing cost.* These terms do not refer to an increase in the production of a single plant, but to an increase in the output of a given industry. We must now examine each case, bearing in mind the fact that the principle of relativity applies here as everywhere; that these three cases are not sharply separated but shade into each other; that in all industries, under all conditions, and for all amounts of production, the forces working toward increasing, constant, and decreasing cost are in some kind of balance—one tendency dominating for some outputs, and another for other outputs, but all three at work everywhere. As production increases in any given industry, decreasing cost generally dominates at first, then constant cost, and finally increasing cost, if production is expanded far enough.

Increasing cost

A commodity is said to be produced at increasing cost when, as production is expanded, the average costs per unit rise. The rise in average costs is ordinarily due to some limitation in the supply of one or more of the factors used in production—land, including all natural resources, labor, capital, or raw materials—and to the consequent necessity of paying more for the services of the limited factor. The most important limitation, in the long run, is that of land; so definitely is this true that agriculture and the extractive industries are usually referred to as the only important industries subject to increasing cost, although other industries which use large amounts of limited natural resources may be said to be indirectly subject to increasing cost. If the automobile industry, for instance, were to expand greatly, it might encounter scarcity and increasing cost of the steel, copper, or aluminum used in construction. The supply of land—all natural resources—is obviously fixed within rather definite limits; hence industries which use large amounts of land are likely to operate according to increasing cost.

Increasing cost arising from a fixed supply of labor or capital is not a long-run normal situation, but rather is characteristic of the intermediate period. If the automobile industry were expanding greatly, it might encounter a scarcity of labor and capital and might have to pay higher wages and interest; but this situation could persist only as long as the industry was expanding. In the long run the automobile industry would reach an equilibrium with other industries, in which the wages and interest paid would be approximately equal everywhere. Industries in general seldom suffer from a shortage of labor, except in wartime, for normally there is some unemployed labor, and often a great deal; and the low rate of interest in recent years indicates that capital is by no means scarce. Over the past half century there has been a steadily increasing population and an even more rapidly increasing supply of capital; but instead of increasing, the supply of agricultural land has steadily decreased as millions of acres are destroyed by erosion each year.

Reasons for increasing cost

The tendency toward increasing cost is shown in Fig. 21. It is obvious from this graph that the expanded production is the result of increased demand and higher prices; but why do costs rise as production increases? For three reasons. In the first place, higher prices bring into use additional land, poorer land on which the costs of production are higher, land which could not be profitably cultivated at the former price but which will yield enough to cover costs at the higher price. The poorest land put into production will be that on which the costs of production—excluding rent, for no rent will be paid for the use of such land—are just equal to the new price of wheat. It is sometimes said that the costs of production on such "marginal" land determine the price; but such a statement involves circular reasoning, because the price of wheat is one of the factors that determine what grade of land is marginal, and therefore it helps to determine marginal costs in this sense. Marginal costs and price are equal, but they are both fixed by all the forces that enter into demand and supply.

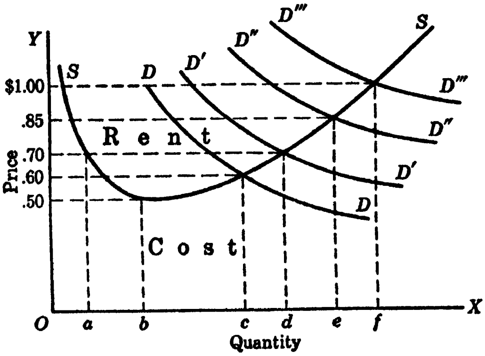

Fig. 21.

In the second place, a higher price for wheat and increased production bring higher costs, because the higher price will shift into wheat production some land which, although fertile, has been used for other crops. In order to secure this good land for wheat production, the individual farmer must pay at least the amount of rent that the land yielded in producing other crops, and to him this rent is a cost which must be met. It is an opportunity cost, that is, a cost which must be paid to take the land away from other opportunities for use. If there were no other such opportunities, the land would already be used in wheat production unless it were submarginal, in which case there would of course be no rent.

In the third place, costs rise with higher prices and increased production, because increased production calls for more intensive and expensive cultivation of the good land, cultivation beyond the point of diminishing returns and therefore at higher cost. It will be remembered that in the cultivation of land—in the "application of units of labor and capital to land," as the law is worded—after the point of diminishing returns is reached, additional units of capital and labor yield a smaller output per unit. Looked at from another angle, this means that the cost of production per unit increases. In other words, increasing cost here is another aspect of the law of diminishing returns.

Why does a higher price for wheat bring more intensive cultivation and therefore raise the cost of production on good land? The answer is that it induces more intensive cultivation largely ***through its effect on rent.*** Theoretically, rent will absorb all or almost all the gain. Wages will not rise much, because they are determined by conditions not in wheat production alone, but in the whole field of agricultural and industrial employment; and interest rates will not rise much for the same reason. If labor and capital are not fully employed in industry in general, wages and interest should not rise at all, theoretically, for unemployed labor and capital will flow into wheat production without any increase in wages. For a while, farmers as entrepreneurs will gain; but their high profits will result in an increased demand for land, which will raise rent to a point where it will absorb *pure* profits. Entrepreneurs in wheat production can earn only what men of their ability earn in other lines of business. So rent absorbs all or almost all the gain from the higher price of wheat. If there were an infinite supply of land as good as that already in cultivation, rent would not rise, and the price of wheat would not rise, or if it did temporarily it would fall back to its former level. The supply of wheat would be perfectly elastic and would be a horizontal line when graphed.

The individual farmer's situation when the price of wheat rises is pertinent here. His marginal costs are not appreciably higher because they represent labor and capital costs, and his average variable costs are increased little, if at all; but in the long run his fixed cost, rent, will be higher because of the increased demand for land, and therefore his average total costs will be higher. Although from the broad social point of view, as we have said, rent is not a cost of production, it is a cost to the individual farmer, and therefore a rise in this factor will raise his total costs of production. Since the total rent of a farm is a fixed amount which does not change with increases in the amount of labor and capital applied to the land, the more labor and capital applied and the more product produced—the more intensive the cultivation—the less will the rent cost be per unit of product. Thus a rise in rent encourages the application of more labor and capital; and the higher the rent, the more labor and capital will be applied. Since, after a certain point, additional units of output can be produced only at increasing cost per unit, a rise in rent raises the average costs of production to the point where they are equal to the higher price.

It must not be assumed that, with a given demand, the price of wheat is higher than it would be if poorer land were not brought in, if land were not shifted from other crops to wheat, and if the good land were not cultivated more intensively. These shifts in land use, and more intensive cultivation, are ways of increasing the production of wheat, and therefore of keeping the price from rising as much as it would if production could not be thus expanded. If there were no submarginal land that could be brought into wheat production, no land that could be turned away from other crops, and no possibility of increasing production by more intensive cultivation, the total wheat yield would be absolutely fixed and the price would rise even more. In that case the supply would be a vertical line when graphed. On the other hand, if there were an abundance of free land as good as that already in use, or if there were no law of diminishing returns, wheat production would not be expanded at increasing cost, and the price in the long run would not rise at all because of an increased demand.

Futility of price fixing

From the preceding analysis we see the folly of trying to benefit farmers *as farm managers*, in the long run, by any scheme for raising the prices of farm products. In many countries, including the United States, the government has definitely adopted a policy of raising the prices of farm products by means of tariffs, export subsidies, limitations on production, and otherwise; but in the long run these policies are for the most part futile. The benefit of such price increases is largely absorbed by the landowners in higher rents, the farm operators gaining nothing; farmers who operate their own land gain as landowners but not as operators. Although farmers in most of continental Europe receive very high prices for their products, they do not enjoy a corresponding prosperity because their rent absorbs most or all of their profits.

Difficulties in calculating costs

We have been considering the costs of production of farm products as if they were something definitely calculable; but it is very difficult to calculate costs for even one farmer, for a number of reasons. One reason is that most farmers produce more than one crop, which brings the law of joint costs into operation. As we shall presently see, it is impossible to ascertain the costs of production of joint products. Moreover, farmers generally depend to some extent on the labor of their wives and children; and this labor is not hired and cannot be accurately appraised. Furthermore, farmers do not produce exclusively for the market, but secure a part of their living from their farms. It is therefore impossible to distinguish clearly between the function of producing their own living and the function of producing crops for market.

Another serious difficulty in computing costs of production of farm crops arises from the fact that the size of the crops varies widely with the weather from year to year and from decade to decade. Some years, in some cases for several consecutive years, the wheat crop in some parts of the semi-arid wheat belt may be scarcely worth cutting or may be a complete failure. Figured for a series of such years, costs of production might be fantastically high, perhaps $5 a bushel or more. For the next year or two the crop may be good, with consequent low costs per bushel. In such cases, the average yield over a number of years must be taken as the basis of calculation.

Still another difficulty lies in the fact that one of the important costs of agricultural products is the depletion of the soil through erosion and the reduction of the chemical elements in it. If our farms were properly cared for on the basis of a permanent agriculture, there would be no need for this charge; but it would be replaced by the considerable expense of caring for the land properly. The charge for depletion is very difficult to calculate, and few farmers allow enough for it. It is even possible that if proper allowance were made for the exhaustion and wasting of the soil, our farmers might prove to have been producing at a loss from the very beginning of settlement, to have sold their *land* and not their crops.

A final difficulty in computing costs of production of farm products is the fact that the costs of individual producers often vary widely. At a given time and in a homogeneous agricultural area, producers of wheat have shown costs ranging from 49 cents to $1.91 a bushel; producers of corn, from 31 cents to $1.23; cotton growers, from 3.5 cents to 16 cents; and potato growers, from 30 cents to $2.45 a bushel. Costs here include all costs but the farmer's wages of management.

Qualities of land in relation to costs

It might appear that the farmers who cultivate good land should have lower costs than those who use poor land, but in the long run this advantage disappears. Because costs, except rent, are lower on the good land, there will be competition for that land until the rent paid for it just equals the advantage of using it, as compared with marginal land, which barely pays the cost of production. Rent is often defined as *the difference between the productivity of good land and that of marginal land;* and the owner of the good land will get this excess productivity as a landowner, not as a farm operator. If he leases the land to a tenant he can compel the tenant to give him this rent, for if one tenant won't, another will; and if he operates the farm himself he will receive the amount as implicit rent. A purchaser of this land has to pay a price which represents the capitalization of the annual rent; and with due allowance for his initial investment, his costs are no lower than those of the operator of marginal land. So we can say that, in the long run, differences in the productiveness of land do not mean differences in the costs of the operators.

Differences in managerial ability in relation to costs

But farmers vary in ability, and their costs vary accordingly. The least capable farmers, those operating at a loss, will tend to be forced out of business; or perhaps, in accordance with the principle of opportunity cost, we should say that those farmers whose efficiency in farming is lowest, relative to their efficiency in other lines of work, are induced to quit farming. There is some doubt as to the accuracy with which the weeding-out process removes the absolutely inefficient. Certainly there is a tendency for the more capable farmers to secure the best land and to crowd the less efficient farmers onto the poorer land. This might seem to make even greater differences in costs, for capable men and good land should have low costs, and inefficient men and poor land should have high costs; but, as already pointed out, rent absorbs the differential advantages of good land.

If we think of the profits resulting from the low costs of the more efficient farmers as merely high wages for their superior abilities, we may include their higher incomes in their costs of production and so bring their costs up to the level of those of the less efficient farmers. There is some logic in doing this, for in the long run pure profits tend to disappear, and all that persists is wages of management. If a given producer has continuously high costs, it may be assumed that his management is poor and that he must allow himself wages low enough to bring his total costs down to those of the more efficient producers. This is likely to be confusing to the student, for we have generally assumed that different producers have different costs, and we shall do so hereafter. Producers do have different costs, *excluding the wage or salary of the entrepreneur;* but to the extent that their relative efficiencies determine their costs, the farmers may properly be credited with salaries just sufficient to bring the total costs of all producers to the same level.

What effect do high prices of farm products have on the average size of farms? It is not certain that they have any effect at all, or, if they do, in what direction. The size of farms is determined largely by other factors than price, by technological factors in particular. Increasingly efficient farm machinery has been primarily responsible for the growth in the size of farms in the Middle West.

The relative size of individual farms depends on the relative abilities of the farmers. The abler men generally have lower costs of production, excluding wages of management —or, to put it another way, they have higher wages of management—and therefore are able both to outbid other farmers in purchasing land and, up to a certain point, to use additional land to better advantage than the less able farmers; in other words, they can farm it at a lower cost per unit of product. Up to a certain point, in adding more land, the able farmers will receive what may be called "increasing returns of management" which result from economies in the use of machinery and in the internal organization of their farms; but after this point is reached they will suffer "decreasing returns of management" because of the various difficulties in managing a large farm. Theoretically they will expand their farms until their marginal returns of management decline to the marginal returns of management received by less able farmers on smaller farms. If, for instance, an able farmer with a 600-acre wheat farm is able to cultivate an additional 80 acres with only the same efficiency—that is, at the same costs—as a less efficient farmer with 300 acres, he will have reached the point where he can no longer expand his farm advantageously.

This is a realistic approach, for in the long run entrepreneurial ability is the only fixed factor in the farm organization. Land, capital, and labor can be added, but the ability of the entrepreneur cannot as a rule be changed; or, if it improves with experience, the other factors will be adjusted to it. The process going on everywhere in the world, not only on farms but in shops and factories as well, is the continuous adjustment of land, labor, and capital to the fixed factor of entrepreneurial ability.

Following this reasoning further, we see a fortunate correlation between the ability of the entrepreneur and the size of his business. In farming, for instance, the ablest farmers are likely to have the largest farms, the best land, the latest improvements, and the best implements and livestock; the least capable farmers have small farms, poor land, and poor equipment. This is indeed fortunate, for if the scheme were reversed—if the able farmers had poor farms and equipment, and the incompetent farmers the good farms and equipment—there would be a tragic waste of the best business ability and of the best land and equipment. In the city, too, the ablest entrepreneurs tend to acquire the best sites, the largest plants, and the best-equipped businesses, where they have ample scope for their superior abilities. The result is the most efficient utilization of scarce and valuable sites, expensive equipment, and human talent; and of course this generally means plentiful and cheap goods for the public.

A tax on increasing-cost products

The principles governing price can often be well illustrated by studying the effects of a tax on the production of a commodity. Let us consider the effect of a tax of 10 cents a bushel on wheat production. Such a tax would operate as an increase of 10 cents in the average total unit costs and would be graphed as in Fig. 22. In this figure *DD* and *SS* are the demand and supply curves before the tax was imposed, and *S′S′* is the supply curve after the tax is imposed, drawn to show an increase of 10 cents a bushel in the costs of production. Before the tax was imposed, the demand and supply curves intersected at *a′*, to fix a price of 80 cents for *Oa* units of production. With the imposition of the tax, the new supply or cost curve *S′S′* intersects the demand curve at point *b″*, to fix a price of 86 cents. Thus the tax of 10 cents a bushel raises the price of wheat to the consumer only 6 cents and lowers the price to the producer 4 cents. The reason for this is that the tax has the effect of reducing production by the amount *ab* along the line *OX*, and thus reducing the marginal costs of production, exclusive of the tax, from *aa′* to *bb′*, or from 80 cents to 76 cents. This reduction in marginal costs absorbs 4 cents of the tax, and the price is raised only 6 cents, which is largely passed on to the consumer.

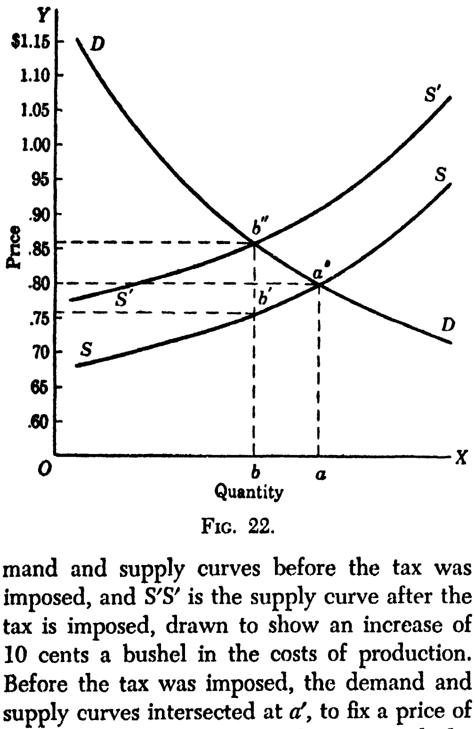

FIG. 22.

How does the reduction in output occur: from the elimination of the marginal producers, or from a reduction in the output of *all* producers? If we assume that the tax is imposed only on wheat production, marginal producers will tend to be eliminated. Since farm incomes for producers of wheat and for producers of other farm products were equal when wheat sold for 80 cents, the drop in price to 76 cents makes wheat farming less profitable than other kinds of farming, and accordingly some farmers will tend to shift from wheat to other crops. If other farmers who were barely making expenses in wheat production cannot shift to other crops, they will be obliged to go into some other business, leaving the marginal wheat land to be returned to grass. Theoretically at any rate, there will be still other farmers, marginal not in the sense of being able to cover only bare expenses but in the sense that they have been making in wheat production only the same wages of management that they could have made in another business, who, if they think that the tax is likely to be permanent and that it is worth while to shift into some other business, will do so.

What of the intra-marginal producers, those who remain in wheat production? Will they produce less than before? Yes, they will cultivate less intensively. For them the tax is the equivalent of a reduced price, and a lower price will bring less intensive cultivation just as surely as, in our illustration above, a higher price brought more intensive cultivation. This will take a long time, for changes in agriculture are made slowly, but theoretically they will be made eventually.

Constant cost

Nature's part in production tends toward diminishing returns or increasing cost; and man's part, if there is a possibility of using machinery, tends toward decreasing cost. But there is a class of goods produced without any important contribution from nature and without the use of machinery, at *constant cost*, that is to say, at approximately the same cost regardless of the amount produced. Constant-cost goods include mainly handmade goods, because such goods seldom require any important contribution from nature and they do not permit such use of machinery as would bring decreasing cost. Representative of constant-cost products are such things as handmade jewelry and hand-carved furniture; handmade laces, embroidery, and rugs; and hand-tailored clothing.

There are other commodities which, although not literally handmade, may approximate constant cost, at any rate for a considerable increase in production. It is likely, for instance, that a considerable increase in cabbage, melons, potatoes, nuts, fruits, and berries might be produced at constant cost. While all of them require land, such crops as cabbage and potatoes yield so heavily that a small acreage produces a great amount, and there would therefore be little pressure on the land; on the other hand, increased production might bring some economies in machinery and marketing which would nearly or entirely balance the increased cost due to diminishing returns from the land. Some kinds of nuts, fruits, and berries may be grown on land that is of little use for anything else, and the yield may be heavy too; and if they were raised in greater amounts they might be handled and marketed even more cheaply. The crop of apples, pears, grapes, sand plums, walnuts, pecans, or raspberries could probably be doubled or tripled at a small or negligible increase in costs. Such crops as raspberries are largely "handmade," which accounts for the fact that they are never very cheap.

If no machinery is used, we are likely to have constant cost; but machines are always likely to be used to some extent if the output justifies their invention and development. All goods were once produced by hand, but machinery has taken over one function after another until even some of the hitherto most definitely handmade products now feel the rough touch of the machine. It is dangerous to set limits to the use of machines or to assume that any given thing will be made by hand regardless of the amount produced. Cigars were long made by hand, but now almost all are machine-made. Much of the so-called hand-carved furniture is now made in part by machinery; even if no big power-driven machines are used, complicated hand machines driven by small dynamos may be employed, with resulting economy in production. Many embroidery designs, formerly done only by hand, are now done so well by machines that only an expert can tell the difference between the two. Engineers and technicians are amazingly ingenious in devising ways and means of doing things; given sufficient money for the cost of experimentation and development, they can make machines that will do almost any kind of technical work. They cannot afford to build machines to turn out only a few hundred articles; but if there were a demand for a million standardized "hand-carved" chairs or bas-reliefs of the Panathenaic Procession, they would soon devise a way to turn them out, neatly carved, with appropriate wormholes and marks of the carving tool, each packed ready for shipment.

While greatly increased production of some things now produced at constant cost would bring decreasing cost because of the introduction of machinery, a similar increase in the production of others might exert more or less pressure on nature for raw materials and thus finally bring increasing cost. If consumers demanded a huge amount of hand-carved furniture, it might raise the price of walnut and mahogany lumber; similarly, if they demanded a very great amount of handmade silverware, it might affect the price of silver. This is a theoretical rather than a practical possibility in the United States today; but in countries where labor is very cheap and natural resources are scarce, the cost of certain raw materials used in hand production definitely affects prices.

When, on the one hand, an industry uses large amounts of a raw material that is produced at increasing cost, and, on the other hand, employs machinery which tends to bring decreasing cost, these two factors may balance each other approximately and establish constant cost. Marshall points out that this might be true in the manufacture of woolen blankets, with wool, the raw material, produced at increasing cost, and the manufacturing done at decreasing cost, the two tendencies establishing an equilibrium at approximately constant cost.

The general conclusion must be that although some products are produced at approximately constant cost in any conceivable quantity, nearly all of those that are commonly referred to as constant-cost products actually deviate from this more or less, and that many of those whose production follows constant cost up to a certain point run into increasing or decreasing cost eventually.

Prices of constant-cost goods

Like any other price, the normal price of a commodity produced at constant cost is governed by the interaction of the demand and supply schedules; but changes in the demand do not affect the price in the long run. Fig. 23 shows clearly that the price is the same regardless of the demand.

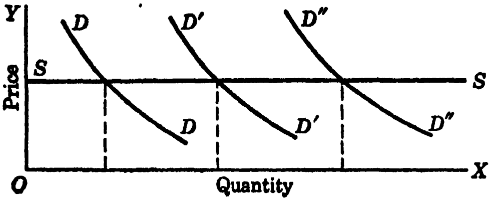

FIG. 23. Constant Cost and Increasing Demand.

A tax on constant-cost products

A tax on a commodity produced at constant cost reduces the amount produced and raises the price by the entire amount of the tax. This is indicated in Fig. 24, which shows that the price is increased by the amount of the tax and that output is reduced from *b* to *a*.

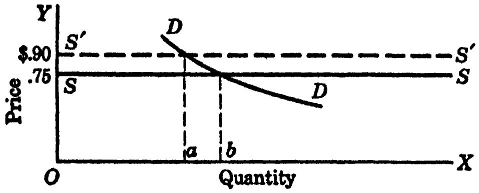

FIG. 24. A Tax on a Constant-Cost Product.

Decreasing cost

We turn now to the type of industry in which man's part in labor specialization and in the development of machinery is important enough to bring decreasing costs—in general, the manufacturing industries, which use much machinery.

Why do costs decrease as production increases? Up to a certain point, because of the economies in the individual plant, in labor specialization, and in the use of expensive machinery, and also because of the other economies mentioned in Chapter 9. Until the total production of an industry reaches a point where at least one plant is operating at the lowest unit costs, the costs for the industry as a whole will decline because of what Marshall calls *internal economies*, economies in the internal organization of the plant. If production never expanded beyond the amount that one plant could produce at lowest total unit costs, there would be a strong tendency toward monopoly, for the plant which gained the initial advantage would have lower costs than the others and would crowd them out.

When production has risen beyond the capacity of one plant, the economies of a further increase are likely to be less important than before, and they are different in nature. They are likely to be less important than before, because if only one plant is producing, at lowest total unit costs, further increases in production are possible only with the addition of more plants, and these will presumably have about the same internal economies as the plant already operating and will therefore operate at about the same costs.

There may, however, be other economies in further increases in production, *external economies*, dependent on the general development of the industry. The cost of machinery, for example, is likely to decline as the expanding industry offers a wider market for specialized machines. A machine builder who designs and makes 1000 machines for a single plant will make them at a high cost per unit; but if he makes 100,000 machines for 100 plants, he can make them at a fraction of that cost. Accessory industries may arise that will provide some of the things needed in the industry—shoe peg factories in shoe manufacturing centers, and plate-glass factories, artificial leather factories, and screw factories in automobile manufacturing centers. In many cases these accessory industries are established or taken over by the particular industry through the process of integration; but regardless of whether they are taken over or remain independent, they are likely to bring a reduction in costs. Marketing costs may also decline up to a certain point in the expansion of output, for each unit sold may help to sell more units. Finally, as production expands, trade journals and various specialized services appear which may enable the producers to reduce costs still further.

These economies operate up to a certain point in production, a point which varies with different industries; but eventually costs cease to decline, and if production is pushed far enough they will rise. There are various reasons for this. For example, as production expands, there may be increasing pressure on land resources or increasing cost of raw materials. In farming, the increasing cost is due to pressure on land resources; and in such industries as copper, leather and woollen manufacturing, it may result from a rise in cost of the raw materials. In industries in which the supply of raw materials is not a serious problem, increasing cost might appear because of a rising cost of labor or capital, or both. The total supply of labor is fixed for the short run, and in the long run it does not tend to expand in response to high wages. A greatly expanding industry would therefore have to bid labor away from other industries, presumably at higher wages than prevailed before. Similarly it might have to bid higher for capital, thus raising the rate of interest. Finally, most manufacturing industries have some selling costs which will increase as production increases and more and more indifferent buyers have to be enticed into buying.

Thus it appears that if decreasing-cost industries expand beyond the point where one plant reaches lowest average costs, they will operate at costs that decline only slightly with external economies, and that eventually they will reach a point of increasing cost.[4]

Prices of decreasing-cost goods

The price of decreasing-cost commodities, like the price of all goods, is determined by the interaction of the demand and supply schedules, the supply schedule in long-run normal value representing costs of production; but the problem here is somewhat more difficult than price determination in the case of increasing-cost or constant-cost goods. Fig. 25 will serve to make it easier.

In this figure, SS is the average cost of production curve for flour of a certain grade; *C, D, E, F,* and *G* represent the individual average cost of production curves for five different plants; and *DD* is the demand curve. For production from *O* to *b* along *OX*, there are declining costs for Plant *C* because of internal economies within the plant; but beyond point *b*—or *b′*, for the individual firm—Plant *C's* costs rise, and it will expand no further. Further expansion in production will come from Plants *D, E, F,* and *G*, with slowly declining costs to *e′*, due to external economies. The declining costs, as more plants are added, benefit not only the new plants but those already in operation; this is indicated by the dotted cost curves for the individual plants, *C′, D′,* and *E′*. The supply curve finally turns upward at point *e′*, and the price is determined, by the intersection of the demand and supply curves, at $1.50 a sack.

It will be noted that there are two intersections of the demand and supply curves, one at *a′* and the other at *e′*; but with curves drawn as they are here, the price cannot be stabilized at any point but *e′*, with *Oe* units produced. Less than *Oa* units cannot be produced because for less than this amount costs will be greater than the price. There might be an equilibrium of supply and demand at *a′*, but it could be only temporary because costs are declining sharply at this point, and in order to secure lower costs Plant C would be certain to expand production and cut prices. It would want to do this and could afford to do it because costs are declining more rapidly than the price—represented by the demand curve *DD*.

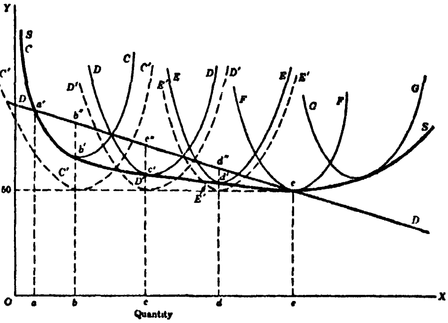

FIG. 25. Price Determination in a Decreasing-Cost Industry.

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[4] On this point, see Frank Knight's analysis (*The Ethics of Competition,* p. 215).

If *Ob* units are produced, the costs are *bb′*, the price *bb″*, and the profits per unit *b′b″*. With a high rate of profits, Plant *C* will expand production by building a new plant, or other entrepreneurs will be attracted into the field.

A tax on decreasing-cost products

It is often said that a tax imposed on a commodity produced at decreasing cost raises the price by more than the amount of the tax; and this holds true if the commodity is really produced at decreasing cost.

The effect of a tax, and also of a bounty, on decreasing-cost goods is indicated in Fig. 26, in which *SS* is the supply or cost of production curve, *DD* the demand curve, *S′S′* the cost curve including the tax *dc*, and *S″S″* the cost curve allowing for the bounty, *de*, the bounty of course operating to lower costs by paying part of them, just as a tax raises costs. The former equilibrium price is *bk*, or *Om*, and the equilibrium amount is *Ob*. The tax, *dc*, raises the price from *k* to *c*, or *m* to *o*, a greater increase than the tax by the amount *do*. The public suffers doubly from such a tax, in that it must pay more than the government receives and has less to consume than formerly, less by the amount *ab*. A bounty, on the other hand, operates as a reduction in unit costs of production, and lowers the price by the amount *kj*, or *mh*—a decrease greater than the bounty by the amount *gj*—and it enables the public to consume *bc* units more than were consumed before. Under such conditions, a bounty brings benefits far above its cost.

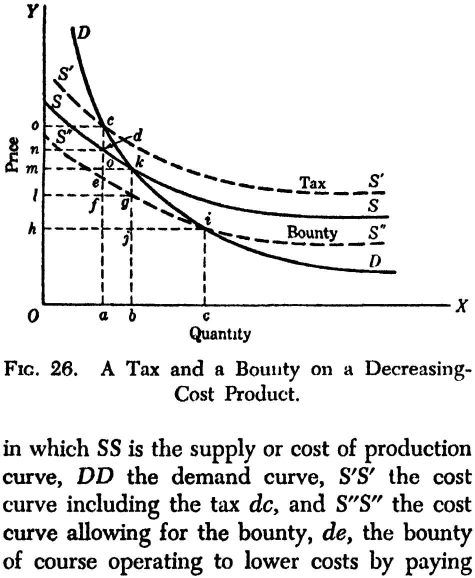

FIG. 26. A Tax and a Bounty on a Decreasing-Cost Product.

General equilibrium of costs and prices

Pure competition assumed, what is the *general equilibrium* in the long-run normal period —not the equilibrium of the demand for and supply of one product in one industry, but the equilibrium of all prices and all productive factors in all industries? It is the equilibrium which would be achieved if conditions remained stationary long enough for all the forces in operation to work out their full effect; it is hypothetical of course, because it is never reached, but it is the equilibrium toward which, to the extent that our economy is competitive, we are always tending.

The long-run general equilibrium is "a condition in which there is no economic motive for change."[5] This means that the prices of all commodities are equal to marginal and average total unit costs of production. (In this period we need not make any distinction between marginal and average total unit costs, because they are necessarily equal.) The prices of different commodities bear the same relation to each other as their respective costs; that is, if it costs twice as much to produce a bushel of wheat as a bushel of corn, the price of wheat will be twice that of corn.

In this general equilibrium, marginal and average productivity of each grade of labor are equal to wages and are the same in all industries; and marginal and average productivity of capital are equal to the rate of interest and are equal in all industries. (We need not distinguish between marginal and average productivity, for in the long run, like marginal and average total costs, they are necessarily equal.) The productivity of labor and capital must be equal in all industries, because if it were not, these two factors would have been shifted from the industries of low productivity to those of high productivity, because of the gain to be derived thereby. All this means that laborers of every grade, and also capital, are producing at least as much as they could produce anywhere, and that therefore the economy's total output is at its maximum. No other distribution will be as productive or yield as large a total in wages and interest. Similarly, all grades of land are being devoted to their highest use and are yielding maximum total product.

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[5] Albert L. Myers, *Elements of Modern Economics*, rev. ed., p. 194.

Such a general equilibrium tends to be reached, in a growing economy, not altogether through *shifts* of producers from one industry to another, but, through the flow of *new* productive resources into the industries in which expansion is needed; and the total investment of productive resources which are shifted and of new resources seeking profitable use is guided by what Boulding calls the *principle of equal advantage*. Producers seeking their own advantage bring more resources into the industries offering the greatest advantages, thus increasing competition and reducing those advantages; and they leave those industries offering the least advantages, thus reducing competition and increasing those advantages until they are equalized. This is the broad, general tendency, subject to the many limitations imposed by monopoly, inertia, sentiment, and ignorance of the relative advantages in different fields of activity. Relative advantages are not entirely monetary, of course. Incomes of teachers, for instance, are much lower than those of doctors, lawyers, and some businessmen; yet there are always plenty of able young men and women seeking teaching positions, men and women who prefer teaching, study, and research to the richer pecuniary rewards of other work.[6]

All productive firms have reached their optimum size and output, and are therefore producing at lowest average total unit costs. Not all these firms are of the same size, because the abler entrepreneurs will control larger firms and will earn larger incomes; but costs for all producers, including the entrepreneurs' wages of management, will be equal and will be at the lowest point.

Consumers will receive maximum utility from the goods that they buy, because production is at the maximum and the various goods are produced in quantities that are adjusted to consumer preferences and at costs equal to the prices consumers are willing to pay. No other distribution of productive factors among industries would meet consumer preferences so well. Any other distribution would result in some goods being produced at costs greater than consumers would pay, while other goods were being produced in smaller quantities than consumers would be willing to buy at prices that covered costs.

All this may seem too fanciful, too good to be true, as indeed it is; but it is the situation toward which the economy, to the extent that it is competitive, generally tends. We have stressed the assumption of pure competition and the assumption that conditions remain stationary long enough for all the forces to work out their full effect; but there are other implied assumptions that have been discussed at various points in the preceding chapters. To mention only two—if consumers are to gain maximum satisfaction they must be perfectly informed and rational, as of course they never are, and they must have equal incomes, as of course they never do. However, to the extent that they are informed and rational and do earn equal incomes, they should enjoy something approaching maximum utility.

Difficulty of controlling prices without controlling supply

From our analysis of normal price we can see some of the difficulties attending producers' efforts to raise prices, unless they can control production. An equilibrium price is the only price that can "clear the market." Attempts to raise or lower it, except through a change in demand or supply, are almost inevitably futile. Hundreds of such attempts could be cited, but a few examples must suffice. Lumbermen's associations have often tried to raise the price of lumber by circulating price lists among their members, quoting prices higher than those set by the competition of the market; but invariably these attempts failed, for the higher prices soon brought an increase in the amount supplied and a decrease in the amount demanded, and lumbermen with heavy stocks of unsalable lumber were forced to slash prices to get rid of them. When they learned later to restrict their output, prices rose without any price lists. Fig. 27 will make this clearer. Here the equilibrium price is $20 and the equilibrium amount is OA. If the price is raised to $25, the amount demanded is reduced to OB and the amount supplied is increased to OC. There are now BC units of lumber which cannot be sold. If the process is reversed and the price is lowered to $15, the result will be an unfilled demand represented by BC.

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[6] See K. E. Boulding, *Economic Analysis*, chap. 9.

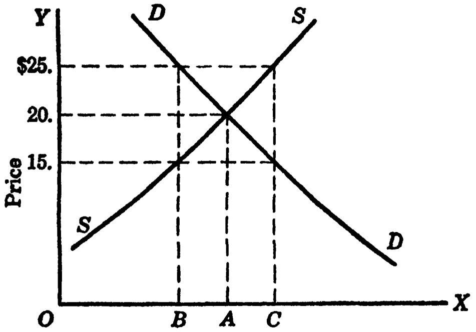

FIG. 27.

Similarly, in the early history of the oil industry in Pennsylvania, producers tried to bolster prices artificially by buying up and storing part of the flow. This worked well enough for a short time, until they realized that the oil in storage constituted part of the potential supply, and when it was sold, prices fell even below the preceding market price.

Government regulation of prices

Government regulation of prices encounters similar difficulties. In Hoover's administration, for instance, the Federal Farm Board was set up to "stabilize" the price of grain above the equilibrium level by buying and storing it; but it presently became evident that the stored grain was part of the potential supply and that it had a depressing effect on market price, almost as if it were actually offered in the market, because buyers thought it might be put on the market. The purchases made by the Board did keep prices up for a time, but eventually the program was admitted to be a failure and was abandoned. Roosevelt's Agricultural Adjustment Administration followed economic logic, at any rate, in restricting planting, in plowing under part of the crops already planted, and even in killing some of the "poor little pigs" whose fate aroused so much sympathy among kind-hearted folk.

In 1945 the Office of Price Administration was trying to keep many prices below the equilibrium point in order to prevent inflation and also to insure a fair distribution of consumers' goods; but there are serious difficulties in any such program. In the first place, only at the equilibrium price are the amounts supplied and demanded equalized; at any lower price, more will be demanded than will or can be supplied. Let us assume, for instance, that the equilibrium price of Premium hams is 50 cents a pound and that the government sets a ceiling price of 40 cents. But at 40 cents the amount supplied will not equal the amount demanded, as is clear from Fig. 28. Here demand and supply are in equilibrium at 50 cents a pound, with Ob units supplied. At 40 cents, only Oa units are supplied, as against the Oc units demanded. But since in the long run SS is also a cost of production curve, at 40 cents the producers between a and b, or between a' and b'' on the SS curve, would be producing at costs above 40 cents, would be losing money, and would finally *have* to abandon hog production. The marginal producers at 50 cents a pound, at b'', would be losing 10 cents a pound at 40 cents. Since only Oa units can be produced at 40 cents, the amounts demanded and supplied can be equated only by a system of rationing which allows consumers to buy less than they would like to buy at 40 cents, or by subsidies granted producers to pay part of their costs. A subsidy of $c'c''$, about 9 cents a pound, shown as curve $S'S'$, would equate the amounts demanded and supplied, for Oc units of output.

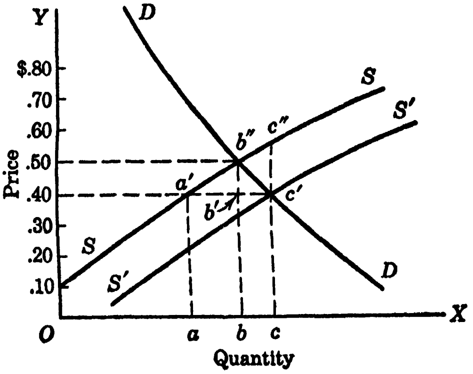

FIG. 28.

In the second place, most finished products are the final result of a chain of productive operations, and their prices are related to the prices of all the productive factors and raw materials used in this chain. Consumers buy the hams from retailers, who buy from wholesalers, who buy from meat packers, who buy the hogs from farmers; the farmers may buy some of the corn and other feed for the hogs, but they are more likely to produce the feed themselves, using labor and implements of various kinds. In normal competitive price determination, the prices of the retailers, wholesalers, and packers, the prices paid the farmers for hogs, the prices of corn and other feed, and the prices of the labor and implements used in producing the corn and hogs are so related that each agent along the entire line receives a price that covers costs of production, but no more. (We are ignoring for the present certain monopoly elements in the situation, particularly in the meat-packing business.) The price of hams to consumers is related to the wholesalers' price, the packers' price, the price that the farmers receive for hogs, the price of corn and other feed, and the price of the labor and the various implements used in feed production. Therefore, when the government fixes one price, it is likely to have to fix all these other prices in such a relationship that at least the costs of production in all the various operations will be covered. This is extremely difficult; indeed, it is so difficult that no government agency can do it with complete success.

But this is by no means the only difficulty in price fixing. The price of every good is related to the prices of many other goods, and when the government steps in to regulate one price it must regulate a thousand others or there will be maladjustments. If, for instance, it sets the price of hams at 40 cents, 10 cents below the equilibrium price, and fixes the prices of other pork products relatively higher, the result will be an increased demand for hams, for many consumers will prefer the relatively underpriced hams to the relatively higher-priced shoulders, bacon, and spareribs. Prices of pork products, furthermore, are related to prices of beef, mutton, poultry, eggs, butter, cheese, and indeed all food products. Therefore the price fixed for hams must be correctly related to the prices of these other products, or the relative production and consumption of these other products will be disturbed; some products will often be unobtainable, whereas others will be so abundant that dealers will have difficulty in selling them. The OPA found it necessary to revise its prices and rationing schedules from time to time to meet such difficulties, allowing consumers to buy less of some products and more of others with their ration coupons.

We see here one of the difficulties in the way of a socialist economy. In such an economy the government would have to fix a great many prices, and to establish the proper relationship between them would be very difficult. Probably a socialist government would be obliged to adopt a scheme much like the automatic demand and supply machinery of laissez-faire capitalism. This, however, will be discussed more carefully in the chapter on socialism.

Joint products considered again

In an effort to simplify economic principles, we have assumed generally that business concerns produce only one product or service; but we must now face the fact that this is rather unusual, that most business enterprisers produce more than one product, some of them a great many. Following Marshall, we defined joint products in the chapter on market price as "things which cannot easily be produced separately; but are joined in a common origin . . . such as beef and hides, or wheat and straw." The market price of such products, it will be remembered, presents no serious difficulties, because it does not call for much consideration of costs of production; but the long-run normal price of such products presents a rather baffling problem, because it depends largely on costs of production, and it is impossible to ascertain these with exactness.

Before discussing this, however, we must get as clear an idea as possible of the concept of joint products in its many varying forms. The student must not expect any precise distinctions, for the principle of relativity applies to the concept of joint products as to most other economic concepts.

A perfect illustration of joint products would be products joined in a common origin, in a certain *fixed* relationship, so that the production of a given amount of one product necessarily results in the production of a certain fixed amount of the other products; for to the extent that the relative amounts of the products can be altered, they are not joint but separate. It is difficult to find a perfect illustration, because the relative amounts of most products classed as joint can be changed to some extent. The relative amounts of beef and hides, for example, have been altered by breeding better types of beef cattle; the Texas steer of pioneer days provided less beef in proportion to hide than the present-day Whiteface. It is likewise possible to change the amount of straw, in proportion to the amount of wheat, by careful plant breeding. If cotton seed became exceedingly valuable, cotton plants would soon be developed with more or larger seeds; cottonseed oil became so important during the Second World War that there was some discussion of this possibility.

Shading away from such fairly clear and simple examples as beef and hides, we can expand the concept of joint products almost indefinitely. Animal carcasses provide the packing industry with more than 200 products in fairly well-fixed proportions. From our wheat crop we get wheat and straw; and from the grain we get bran, flour of several grades, and a number of cereal foods. From our corn crop we get not only feed for livestock and poultry, with the resulting production of a hundred meat products and as many dairy products, but also many kinds of cereal foods, syrup, and other foods.

In some regions of our country, farming is devoted largely to the production of a single crop—wheat in central and western Kansas, cattle or sheep in some parts of the semi-arid West, cotton in certain sections of the South—but in the more common diversified farming a considerable number of products are produced—perhaps corn and wheat and clover and grass, cattle and hogs and chickens; milk and eggs. Although these are not produced in invariable proportions, most or all of them must be produced if farmers are to meet expenses.

In farming, as in some other businesses, we face another complicating principle. In some respects farm products are joint products, but in other respects they are alternative products. The diversified farmer must produce a number of products; but to the extent that he produces some of these at any given time, he can not produce others. To the extent that he produces corn he cannot produce wheat, and if he sells the corn he cannot feed and sell livestock; although a good flock of poultry will yield both eggs and dressed poultry, to the extent that he sells dressed hens he clearly cannot sell eggs, because dressed hens will produce no more eggs. If the farmer has sheep he will normally produce some wool and some mutton. These are truly joint products, but they are also to some extent alternative products, for if he is primarily interested in mutton he must raise a breed of sheep which yields mainly mutton rather than wool; furthermore, whatever the breed, when he sells mutton he stops the production of wool.

Every retailer produces something analogous to joint products, or perhaps we might better call them joint services. A druggist ordinarily sells a thousand or more different items—drugs, medicines, cosmetics, tobacco in various forms, candy, soft drinks, and books and magazines. If he is to prosper, he *must* sell most of these things, because if he does not offer an adequate selection of goods he will lose business. Railroads—to turn for a moment to a monopoly—are often said to provide joint services: passenger service, perhaps of several grades, express and mail transportation, and freight transportation for hundreds of different classes of goods at various rates.

A great many industrial products are somewhat similar to joint products. Furniture manufacturers make bureaus and tables from wide boards, chairs from smaller boards and sticks, and excelsior and sawdust as by-products. All these are "joined in a common origin" because they come from the same wood; but they are not joined in the same sense as wheat and straw are, for they are made into separate products not by nature but by man. It is not nature but the imperatives of the furniture manufacturing business which make it necessary to produce a variety of different products; yet this "jointness" is similar in some respects to the "jointness" of true joint products.

In manufacturing there has recently been a strong trend toward increasing product diversification. In 1937, none of the fifty largest manufacturing companies produced less than 6 products, one produced 302, and fourteen produced between 100 and 302. In most cases one or a very few products constituted the great bulk of the business, the others being produced, presumably, because they increased profits or enabled the producer to avoid losses. Industrial research and the rapid advance of science and technology have made this diversification of products both possible and, as a matter of business expediency, necessary. Research is constantly bringing out new processes, new ways of doing things, new products. One oil company that was seeking a method of diluting oil discovered that alcohol could be made from waste gases in the refineries and could be put back into the refined gasoline; this led to the production of an efficient anti-freeze, a basic chemical solvent, an anti-knock fluid, and other products. When research in the rubber industry developed new uses for rubber, one manufacturer of tires and rubber footwear added mattresses and automobile cushions to his products.

Various business considerations may induce a producer to diversify his output. In the first place, he may find it expedient to carry a full line for the convenience of distributors, salesmen, or consumers. In food retailing, for instance, grocery stores and meat shops were formerly separated, but it was found that they could supply the public better by combining in one shop. Distributors of radios similarly have added other household electrical appliances to their business, and to meet the needs of these distributors some manufacturers have added these other products to their output. In manufacturing, the same trend toward diversification is clear and widespread. A patent-medicine company found it profitable to produce a variety of goods: "surgical dressings, rubber sundries, grape juice, crushed fruits and syrups, envelopes, drinking cups, chocolate, cocoa, candy coatings, surgical gauze, drugs, and other articles commonly sold in drug stores."[7]

In the second place, some producers diversify their output in order to make better use of their productive resources. A certain company added a number of products because it did not have enough originally to carry the overhead. A manufacturer of sound-transmission equipment added electric razors and coin-weighing machines because their manufacture made possible the fuller use of his managerial staff and skilled workers. In some cases a decline in the demand for its original products has forced a company to add others. A manufacturer of newsprint, facing a shift of production of newsprint to Canada, found it necessary to add book, bond, and hanging paper to his line. After a war, many producers of war materials are obliged to return to the production of peacetime goods, in some cases articles that they have not produced before. In some cases the seasonal demand for one product has forced producers to add a product that is in demand at another season, in order to keep their managerial staffs and laborers fully employed. A manufacturer of sleds thus found it profitable to add a line of garden tools.

An increasing number of products are being turned out because manufacturers are learning to produce more products from their raw materials; what were once waste products are being made into valuable by-products. Illustrations of this are so numerous and so familiar that none need be cited. It is likewise unnecessary to elaborate further regarding the many other factors that have increased the number of products of industry. Enough has been said to show that a theory of price based on the assumption of a single product, although of fundamental significance in the study of economics, is to some extent an unreal simplification of a vastly complicated problem.

Long-run normal price of joint products

The market price of joint products, as we saw in the chapter on market price, is determined simply by demand and supply; but when we come to determining costs of production and long-run normal price of such products, we are faced with a problem which can be solved only in a very general way. A few principles may, however, be set down as sound.

In the first place, the sum of the prices of both or all the joint products derived from the common parent product must equal the average total costs of producing the parent product, and they cannot be more than this in pure competition, according to the general principle governing value. If we assume that only cotton fiber and cottonseed oil are produced from the cotton stalk, the sum of the prices of the fiber and the oil have to equal the total costs of producing the parent crop, in the long run; and they cannot be greater than this, for if they were, farmers would be attracted into the business, the supply would be increased, and the price would decline to the level of average total unit cost. The costs of individual farmers would be raised by competitive bidding for cotton land, and this in turn would raise rents. Similarly, the sum of the prices of all the products of a furniture manufacturer have to equal the total costs of producing all of them; the sum of all the prices received by a drugstore operator for the hundreds of commodities and services he sells must equal the total costs of operating the store, or else he will be obliged to close shop.

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[7] Temporary National Economic Committee, *Monograph No. 27*, p. 651 ff.

In the second place, the long-run normal price of *any one* joint product, produced under conditions of pure competition, cannot exceed the cost of producing the parent product. The price of cottonseed oil or of cotton fiber cannot remain above the total cost of producing the parent cotton crop, for if it did, the profits made on the one joint product—even if the other product were worthless and were thrown away—would attract other producers into the business until the price would be forced down to the cost of production of the parent crop. Similarly, the price of wool cannot remain above the cost of raising the sheep; and to the extent that there is competition, this principle applies also to the chairs or tables produced by furniture manufacturers, or to any other industrial joint product or by-product.

In the third place, the price of a joint product, whether competitively produced or not, obviously must not in the long run be below the *direct* cost of *processing* it, for if it is, the material from which it is made will be thrown away. If cottonseed oil or Crisco cannot be sold for enough to cover the direct cost of pressing it out of the cotton seed, the seed will be thrown away; if any industrial joint product does not bring enough in the market to cover its direct cost, with no allowance for the general expenses of the plant, it will not be produced.

Here then we have an upper and a lower limit between which the price of a joint product must in the long run be fixed; the total costs of production of the parent product is the upper limit, and the direct cost of production of the joint product is the lower limit. These limits are generally so far apart as to be of very limited use, but fortunately there are two other principles that are helpful. When it is possible to vary the proportions in which two joint products are produced, we can find the cost of one *in terms of the other*. In the case of wool and mutton, for instance, wool can be substituted for mutton, or vice versa, by choosing the breed of sheep which produces one or the other in greater quantities. If by doing this we can get 10 pounds of wool by sacrificing 20 pounds of mutton, assuming that the animals can be maintained at equal cost, we have the cost of producing wool in terms of mutton, or of mutton in terms of wool. In retailing and also in manufacturing, to turn to less definitely competitive businesses, the producer can usually vary the output of his various joint products and so can figure roughly the cost of one product in terms of the others. This is obviously analogous to the principle of opportunity cost; the opportunity to produce mutton is a cost in the production of wool.

Turning to the demand side of the price problem, we find another principle which may be helpful in determining long-run normal price. The price cannot be above what the "traffic will bear"—in this case, what consumers will pay—and this point varies, of course, with the amount sold.

Retailing provides an illustration of the principle of joint costs in an effectively though not purely competitive business. If the druggist, who must carry countless different articles in stock, were to try to figure out the cost of handling any particular article or class of articles, he would face the principles of joint costs as we have outlined them. In adding a few novelties, for instance, he would have to set prices high enough to cover the direct cost of selling them, but no higher than buyers will pay; and, just as the sheep producer must to some extent sacrifice mutton for wool, so he would probably have to figure, as a cost in selling the novelties, what he could earn with the space and sales force in selling something else. The truth is that no retailer can figure with much accuracy the cost of selling any of the many joint products of his business. If he is to do business at all, he must have a fair selection of goods and fix his prices at levels which will enable him at least to meet expenses. The relative prices of the different articles will be determined largely by the custom of his trade, within the broad limits set by such principles as we have considered.

In the case of true joint products, such as mutton and wool, there are some rather peculiar price relationships. An increase in the price of any one such product tends to reduce the price of the other product, and a fall in the price of any one such product tends to raise the price of the other. Thus a rise in the price of cottonseed oil tends to reduce the price of cotton fiber because it makes the growing of cotton more profitable, attracts farmers into cotton production, and so increases the supply of cotton fiber as well as of cotton seed, with a consequent price decrease for the fiber. But to the extent that the products are alternative, a rise in the price of one *may* raise the price of the other. Dressed poultry and eggs are in a sense joint products of the poultry business, but a rise in the price of dressed poultry may induce producers to sell dressed hens and so reduce the supply and raise the price of eggs.

Other cases of deviation of price and cost

Joint products are not the only ones whose prices are imperfectly related to costs of production. Monopoly price may remain above costs for an indefinite time, as may also monopolistically competitive price for a considerable period. In some cases producers shift part of their costs to others, in many cases to the public. In times of depression most industrial concerns throw upon the people much of the cost of supporting unemployed laborers, although this is truly a part of the costs of manufacturing. During the Great Depression, the city of Detroit and the federal government were forced to assume some of the costs of caring for thousands of Henry Ford's laid-off workmen, thus paying some of the cost of Ford cars. Many industrial concerns wear their workers out and then leave them to the public for support. The dust in certain kinds of mining leads to tuberculosis; and the miners so affected must often be treated and cared for at public expense. Many kinds of enterprises do public damage for which they do not pay. Factory smoke envelops Pittsburgh, Chicago, St. Louis, and indeed almost all our other cities; the fumes from smelters may kill all the vegetation for miles around; waste liquids from many industrial plants kill the fish in nearby streams and make the water unfit for general use; lumber companies usually leave a melancholy waste of burned slash and denuded land behind them; meat-packing plants can often be smelled a mile away and the value of homes within a wide radius is reduced or wiped out; mines commonly leave unsightly heaps of slate and debris which permanently disfigure the landscape; oil operators sometimes permit oil or salt water to seep into streams and fresh ground water, thus ruining water wells for miles around. Such damage is part of the costs of production, but it is paid for by the people, and not as a rule by the producer responsible for it.

QUESTIONS

1. Why is there no analysis of demand in the discussion of long-run normal price?
2. What has the increasing cost of production of farm products to do with the law of diminishing returns?
3. Why must we pay a higher price for wheat when we want more of it? Whom does the higher price benefit in the long run?
4. Herbert Hoover says that agricultural products are subject to a peculiar law—that the lower the price the more will be produced, and the higher the price the less will be produced. Is this true? Comment on it.
5. Name some products produced at approximately constant cost.
6. "The costs of all farmers are the same, in the long run, regardless of their efficiency." In what sense is this true?
7. "Demand has nothing to do with the determination of the normal price of a commodity

which obeys the law of constant cost." Do you agree? Draw a diagram to illustrate.

8. How, if at all, would doubling the demand for a constant-cost commodity affect, in the long run, (a) its marginal utility, (b) the quantity exchanged, (c) its price per unit, (d) its cost per unit?
9. "Instead of the labor expended being the measure of the value of the commodity, the value of the commodity is the measure of the labor rationally to be expended in its production." Explain.
10. Does the marginal cost of production determine the price of oil, or does the price of the oil determine the marginal cost of production? Explain.
11. It is often stated that prices—the average of prices—are higher in New York City than in any other part of the United States. Since money flows freely within a country, how can one place have a higher price level than other places? Can Illinois or Utah or California have higher average prices than Kansas? What principles will determine your answer?
12. "In any community the great mass of consumers consists of the laborers. The lower the level of wages; therefore, the more restricted will be the total demand for the national products in general and the slighter the chance of reducing costs by expanding the market. Low wages which mean low costs in some industries may thus indirectly prevent a reduction of costs in other industries." Do you agree?
13. It cost Mark Twain more than a hundred thousand dollars to develop a typesetting machine, which proved worthless. What becomes of the theory that cost of production determines price in the long run?
14. Distinguish internal from external economies. Which of these is secured by the concentration of the big department stores in the Loop in Chicago? Which is secured by the publication of trade journals?
15. "The cost of production of the marginal product can be ascertained without reasoning in a circle. The cost of production of other parts of the product cannot." Why?
16. A farmer builds a garage with worthless boards that he picks up around the yard. What is the cost of the garage, fundamentally?
17. Do costs of production include marketing costs? Why or why not? What selling costs are there in a purely competitive industry? How do you account for the advertising of butter by the American Dairy Association?
18. Mention cases where, even in the long run, price may deviate from cost of production.
19. Draw graphs to show the effects of a tax and a bounty on products produced at increasing, constant, and increasing cost.
20. What is a joint product? How is its market price determined? Within what limits can the cost of production and the long-run normal price of such a product be determined? What effect will an increased demand for cotton fiber have on the price of cottonseed oil in the market price period? In the long-run normal price period? If the costs of raising cotton declined, what would be the long-run effect on the price of cottonseed oil? What factors would determine the relative effects of this decline on the price of the fiber and of the oil?
21. Bausch & Lomb Optical Company manufactures 17,000 different products. How would the company figure the average total unit cost of production of any one of these products?
22. If the price of wheat were fixed somewhat above the equilibrium price, would not producers put on an energetic sales campaign to sell their wheat? Does the wide prevalence of advertising and salesmanship suggest that many prices are too high? If they were generally reduced, would as much energy and expense be devoted to such selling activities? If they were reduced sharply, might buyers compete for goods, rather than producers compete for sales?
23. The AAA restricted the production of farm crops and so raised prices. Did this increase the net income of farmers as farm operators? Since every farmer had to reduce his output, what effect did the AAA's action have on average total unit costs? Draw a graph to show the effects of the AAA program on the individual farmer's situation.

Chapter 17.

Long-run Normal Price: Monopoly

The concept of monopoly

Monopoly, as we have already seen, is a very hazy concept, since there is no pure monopoly and no absolutely pure competition; but we have defined monopoly as *control over supply and price,* the control being always more or less complete, and never absolute.

There are more or less satisfactory substitutes for almost all monopoly-produced goods and services in some of their marginal uses. For city water, electricity, and telephone service there are no very close and satisfactory substitutes; but for some other monopoly-controlled goods—aluminum, sulphur, nickel, and cranberries—fairly satisfactory substitutes are available. The more satisfactory the substitutes, the more elastic the demand; that is, the more nearly horizontal the demand curve will be. No monopoly faces an absolutely inelastic demand curve.

Control may relate to the amount supplied or to the price, but these amount to practically the same thing, because restriction of the amount supplied always brings a higher price, and the setting of price above a competitive level makes necessary the restriction of the amount supplied. This may be illustrated by assuming that a monopoly succeeds in securing control of the total grapefruit production of the United States. Fig. 29 shows the price situation.

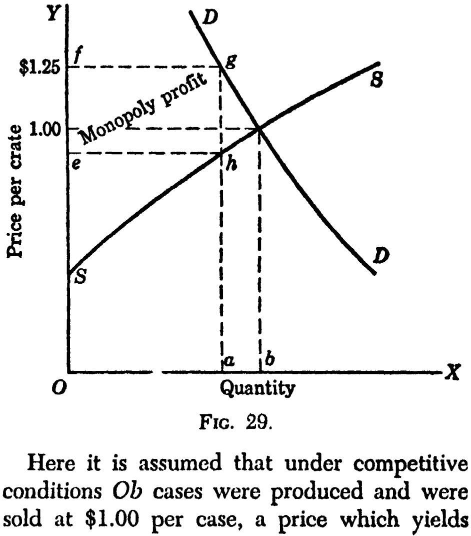

FIG. 29.

Here it is assumed that under competitive conditions *Ob* cases were produced and were sold at $1.00 per case, a price which yields only costs of production. The monopoly, seeking monopoly profits, may reduce the amount supplied to *Oa,* for which it can secure a price of $1.25. If it raises the price to $1.25 it *must* reduce the amount supplied to *Oa,* because that price can be maintained for no other amount. The raising of price and the curtailment of the supply must go together. A monopoly can get no higher price for a given amount of product than can a number of competitive producers. At $1.25 the grapefruit monopolist makes a monopoly profit of *efgh.*

Monopoly and demand

The demand is usually assumed not to be affected by monopoly, yet a monopolist might be in a better position to advertise, in an effort to raise the demand, than a large number of competitive producers. As we have already seen, no competitive producer of an almost perfectly identical product such as wheat can afford to advertise at all, because the product is known to be practically identical for all producers. As a rule, no single competitive producer of even a somewhat differentiated product like grapefruit can afford to advertise grapefruit as a product, because, while he might increase the demand slightly, he would pay all the cost of the advertising and would receive only a very small share of the benefit resulting from this increased demand. Unless he produces a large supply of really superior fruit, he cannot afford to advertise to build up a preference for his own product over that of others. On the other hand a monopoly, controlling the entire or almost the entire supply of such a product, might well find it profitable to advertise, as some of the California cooperative fruit and nut monopolies have done. Yet advertising usually suggests not monopoly but competition, monopolistic competition. When the Standard Oil Company had almost complete control of the oil industry it did little advertising. Advertising to build up the demand for a given product implies that there are competing products claiming the attention of consumers, who may be weaned away from them by advertising. To the extent that the monopolist must try to strengthen demand, his position appears to be competitive.

The long-run normal price fixed by a monopolist depends upon the elasticity of the demand and on the conditions governing costs. The influence of the elasticity of the demand on the monopolist's price policy has already been discussed in connection with market price, and its influence is the same on long-run monopoly price. The greater the elasticity of demand—the more nearly horizontal the demand curve—the less will the monopolist be able to exploit his position by reducing production and raising prices, for a small price increase will cause a relatively large reduction in the amount demanded. On the other hand, the more inelastic the demand—the more nearly perpendicular the demand curve—the more will he be able to exploit his position by reducing production and raising prices, for a small reduction in output will bring a relatively large increase in price. As has been said, the elasticity of the demand depends on a variety of factors, but on the availability of substitutes in particular.

Industry-wide monopoly vs. single-plant monopoly

A monopoly may control an industry or it may operate a single plant; and according as it does the one or the other, its cost curve will be either that of an industry or that of an individual plant. The United Shoe Machinery Company is an example of the former; and a small local hotel or retail store or the manufacturer of a small patented gadget is an example of the latter. If the United Shoe Machinery Company expands output, it does so by adding new plants; and if costs decline, it will be because of *external* economies, changes in conditions in the industry and not in the individual plant. If costs rise, it will also be because of changes in the industry as a whole, perhaps increasing difficulty in getting certain raw materials. If a single-plant monopoly expands output at decreasing cost, it will be because of *internal* economies, those resulting from more minute specialization, better utilization of machinery, and the like. Such monopolies would seldom encounter increasing cost with expansion of output. We shall consider first the industry-wide monopolies.

Industry-wide monopolies: increasing cost

In our study of competitive long-run normal price we found that industries may encounter increasing, constant, or decreasing cost as they expand production. Industry-wide monopolies are subject to the same conditions as regards cost. Increasing cost, as we have seen, characterizes those industries in which nature plays an important part, particularly agriculture. There are not many monopolies in this category, yet monopolists who exploit natural resources may be subject to something analogous to increasing cost. The principle of diminishing returns or increasing cost does not apply to the gradual exhaustion of resources over a period of time; but it may be said to apply to the exploitation of resources in the sense that if a mining company operates only its richest mines, it might produce currently at somewhat lower costs. A telephone company is a better illustration, for it is said to operate at increasing cost. This is not strictly accurate, for although the costs of the service rise as the number of subscribers increases, the nature of the service changes. Telephone service in a large city costs more than in a small city, but it puts the subscriber in touch with a larger number of other subscribers and is in that respect a superior service. For the purpose of our illustration, however, we may ignore such changes. By keeping the price high, the telephone company may gain a monopoly profit, not only from the high price but also from the fact that with a smaller list of subscribers its unit costs are lower. Monopolies operating at increasing cost thus have a double incentive for reducing production.

Monopoly price with increasing cost is shown in Fig. 30, in which the monopolist reduces production from *Of* to *Ol*, thereby raising the price from *b* to *c* and at the same time reducing costs from *b* to *a*, thus securing a monopoly profit of *acde*.

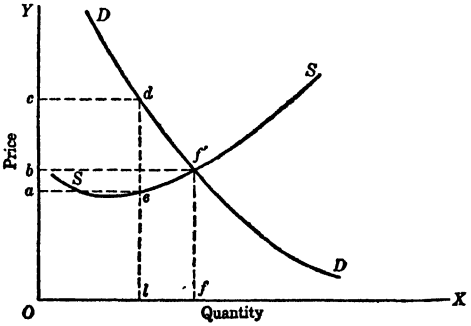

FIG. 30. Monopoly Price with Increasing Cost.

Monopoly profit should perhaps be defined here. Although this term is not always used in the same sense, for our purposes it may be defined as ***the excess of income above total costs, including wages of management, gained through monopoly control of supply and price.*** It is a *pure* profit in the sense that it is in excess of wages of management; but unlike the pure profits which appear sporadically in competitive businesses in the short run, it does not always disappear in the long run.

Monopoly in constant-cost industries

Industries subject to constant cost because of the prevalence of handwork are not often subject to monopoly control. Such a monopoly, however, would not need to consider possible changes in costs resulting from a reduction in output; it would consider only the elasticity of the demand. As Fig. 31 shows, for production of *Oe* units the monopoly profits are *abcd,* and for *Ol* units they are *aghi.*

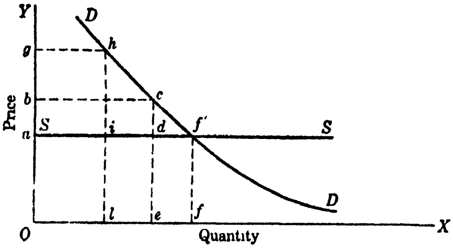

FIG. 31 Monopoly Price with Constant Cost.

Most monopolies are in the class of industries commonly known as decreasing-cost industries; but we have already seen that in the long run the only industries operating at decreasing cost, as far as internal economies are concerned, are those in which the total product is not sufficient to enable even one plant to operate at the lowest cost. Therefore most of the so-called decreasing-cost industries really operate at *nearly* constant cost. Thus the principles governing monopoly price determination at *nearly* constant cost are widely applicable.

Monopoly in decreasing-cost industries

If the industry does operate at definitely decreasing cost, any restriction of output will of course raise average costs as well as price; and the amount of restriction which will yield the highest net profits depends on the relative slopes of the cost and demand curves. If, as output is reduced, the costs presently rise as fast as the price, the monopoly will stop reducing production, because it will make the same profit per unit on a smaller number of units. To justify reduction of output, the price as indicated on the demand curve not only must rise faster than costs as output is reduced, but it must rise so much faster that the increasing profit per unit will more than offset the decreasing number of units on which the profit is made. This situation does not need to be graphed.

Single-plant monopolies

Turning now to the single-plant monopoly, we find the same principles operating, but not in exactly the same way. In the industry-wide monopoly, rising cost may be due to the law of diminishing returns, but in the single-plant monopoly this is seldom true. Similarly, decreasing cost in the industry-wide monopoly is usually due to external economies, but in the single-plant monopoly it is due to internal economies. For the single-plant monopoly we may use, with a few significant changes, the analysis and graph employed in our analysis of price in the intermediate period. The graph is shown in Fig. 32.

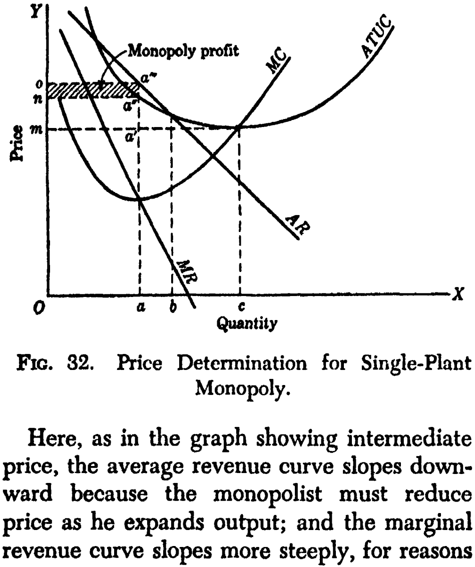

FIG. 32. Price Determination for Single-Plant Monopoly.

Here, as in the graph showing intermediate price, the average revenue curve slopes downward because the monopolist must reduce price as he expands output; and the marginal revenue curve slopes more steeply, for reasons which have already been elaborated. There is no fixed cost curve, however. Why is this? Because the long-run normal period, as we have defined it, is long enough to permit changes in fixed plant; and therefore in this period *there are no fixed costs,* no costs that remain the same as a total, as output expands. The fixed costs of the intermediate period are variable costs in the long-run period. Moreover, since there are no fixed costs in this period and since total costs are the sum of fixed and variable costs, the distinction between variable and total costs disappears. All costs are variable, and therefore variable and total costs are identical. In Fig. 32, one curve serves for both. Marginal costs—the addition to total costs due to the addition of a given unit of output—are the same as in the intermediate period, and the monopolist expands production to the point where marginal costs equal marginal revenue, and sells his product for what this output will bring.

We come then to the conclusion that the single-plant monopolist adjusts production at the point where marginal costs equal marginal revenue. In this respect he is like the competitive producer, for the latter also sets his output at this point.

Differences between monopoly price and competitive price

The final equilibrium of a monopoly differs from that of a competitive producer in several respects. Since the monopoly faces a sloping average revenue curve, and therefore a more steeply sloping marginal revenue curve, it is induced to produce less than a competitive producer, and at higher average total cost. If the producer in Fig. 32 were purely competitive, he would expand output to *c,* the point of lowest average total unit costs, rather than to *a,* the point of maximum monopoly profit.

It will be seen that consumers in general are adversely affected by monopoly in three ways. In the first place, since monopoly-produced goods are usually scarce goods, consumers have *less of the products* than they would have if they were competitively produced, less by the amount *ac* in Fig. 32. In the second place, since monopoly price is usually a high price, consumers must pay a *higher price* for the smaller output of the monopolist, higher by the distance $a'a'''$, or *mo.* In the third place, the public as a whole suffers from the *high costs* of monopoly-produced goods. The monopolist in Fig. 32 produces at average total unit costs of aa'', or *On,* which is above average total unit costs of an equally efficient competitive producer by the distance $a'a''$, or *mn.* These costs represent a wasteful use of productive resources, and the total output of goods in the economy is less than it would be if the monopolist produced at lower costs. The entire problem of these effects of monopoly must be analyzed more carefully.

1. Practically all urban industries deviate more or less from pure competition; that is, they are to a lesser or greater degree monopolized and therefore restrict production more or less. On the other hand, agriculture approaches pure competition; and retailing and small service enterprises are at least effectively competitive, some of them severely competitive. Thus we have an unbalanced economy, with the monopolistic segment skimping production and the competitive segment producing without restriction; and as a result we have too little of the monopoly-produced goods and too much, relatively, of the competitively produced goods. Skimping production, the monopolists must also skimp in their use of labor and capital, and so they force labor and capital out into the competitive industries, with the result that wages and interest are depressed there. Thus monopoly in one part of the economy defeats the tendency of competition to establish equal marginal productivity for productive resources in all industries, and reduces total production.

2. Since the monopolist restricts production, he raises prices. The consequences of this depend on the elasticity of the demand for the monopolized product. If the demand approximates unity, consumers may buy less, spending on the product the same total amount that they would spend for it if it were competitively produced and cheaper, and spending as much for other competitively produced goods as if the entire economy were competitive. In this case, the competitive producers will not suffer any *direct* reduction in the demand for their products, although they will of course be affected by the fact that, by reducing output, the monopoly has forced productive factors into the competitive segment of the economy and has thus increased the amount of goods and reduced the prices there. If the demand for the monopolized product is inelastic, consumers will spend *more* of their money for *less* of the product, and so will have less to spend for competitively produced goods. In this case consumers will be able to buy less of *all* goods. If the demand for the monopolized product is elastic, consumers will buy less of it and thus spend less, but not proportionately less, and will have *more* left to buy competitively produced goods. This situation will certainly not be common, because in the face of an elastic demand curve the monopoly will not dare reduce production and raise prices very much. The general over-all result will probably be higher prices and smaller purchases of monopoly-produced goods, but a larger total expenditure for them, and therefore a decreased demand for competitively produced goods. This means not only a reduction in the total amount of consumers' goods, but low incomes for the entrepreneurs and laborers in the competitive segment of the economy, low incomes from which they cannot escape because, for one reason or another, there is not freedom of entry into the more profitable monopolized segment of the economy.

In times of business recession the division of the economy into monopolistic and competitive segments is a particularly serious matter. In the recession of 1929–1932, for instance, "while the prices of agricultural commodities declined 54 percent and production fell off only 1 percent, the prices of farm machinery were reduced by only 14 percent and production dropped 84 percent."[1] Such an unbalanced situation meant distress for farmers, who had work but got little or nothing for it and could therefore buy few farm implements and little of anything else; distress for farm implement workers, most of whom had no job and could not buy even the barest essentials of a decent living; and distress for a great many producers of other goods that could not be sold because the unemployed implement workers and the poverty-stricken farmers had little money to spend. Partly as a result of monopoly, not only in the implement industry but in various other lines, there were many unemployed workers, much unused capital, factories deserted or working part time, machines idle and rusting. Monopoly causes a lack of balance in the economic system, with a resultant serious waste of human and capital resources. A few monopolies in the economic system, like a few fleas on a dog, are not very serious; but too many monopolies or too many fleas may seriously impair economic or canine health.

3. A monopoly may produce at higher costs than a competitive producer, for several rea-

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[1] Temporary National Economic Committee, *Monograph No. 21*, p. 127.

sons. In the first place, even if the management were as alert and progressive as that of a competitive business, the monopoly would have higher costs because, unlike a competitive producer, it does not expand production to the point of lowest average total unit costs; this has already been explained. In an industry-wide monopoly with many plants, this presumably would not be important, for if the number of plants is restricted, the plants in existence could be made large enough to secure at least maximum *internal* economies. But when a previously competitive industry is monopolized, it may be necessary to abandon some of the plants, as the sugar monopoly once did. This of course represents an unfortunate waste of capital, a waste that may increase with time; for if a monopoly is highly profitable and if there is no fence around the industry in the form of patents, ownership of essential resources, or some similar restriction, the industry may be invaded by competitors whom the monopoly will have either to fight or to take into the combination. Since there is no profit in fighting, it may well follow the latter course, thus adding to a capital investment which is already too large, and so raising costs. A single-plant monopoly may secure maximum monopoly profits by building or using a plant that is too small to secure lowest average total unit costs, or by operating at less than full capacity.

Monopoly and efficiency of management

A monopoly may operate at high costs for another reason. In the chapter on monopoly we saw that monopolies *may* be managed less efficiently than competitive businesses. It is not surprising that some monopolies are inefficiently managed, because there is not the same necessity for efficiency as there is in a competitive industry. A monopolist can usually make more profits if he is efficient, but if he is in a fairly strong position his business life does not depend on his efficiency. In the case of public utilities, it is difficult to see any good reason why the officers should even *care* to develop more than ordinary efficiency, for public utilities are supposed to earn only a certain rate of interest on their investment; and superior efficiency, if the public regulating agencies detect it in lowered costs, would merely result in their being obliged to lower their rates to the public. Efficiency in a public utility might reasonably be expected to take the form not of low costs but of political machinations to prevent unduly effective regulation.

A monopoly *may,* however, have lower costs than competitive producers, because of the elimination of the wastes of competition, particularly competitive advertising and salesmanship. It may also be able to deal with labor more effectively and keep wages lower; it may buy raw materials, machinery, and supplies of various kinds more cheaply and sell its products to better advantage; and it may be able to maintain better research departments and use newly invented machinery and processes to better advantage, fight patent infringements more effectively, or appropriate the others' patents more successfully, if this is more profitable. Most of the advantages of large-scale combination accrue to a large monopoly, and some others that an ordinary combination does not enjoy. It must not be assumed, however, that the low costs sometimes enjoyed by monopolies are necessarily reflected in lower prices to consumers. They are more likely to appear as generous monopoly profits.

Limitations on monopoly power

Some of the limitations on a monopoly's power to raise prices have already been pointed out. Thus we saw that if the demand is highly elastic, if there are fairly satisfactory substitutes, the monopoly cannot raise prices to any great extent. For this reason, some of our monopolies do not impose great hardships on consumers—perhaps even less than some of the earlier monopolies did when fewer goods were produced.

Furthermore, potential competition may set a certain very elastic limit to the price a monopoly will charge. In such a business as supplying water to a large city there is practically no possibility of competition, and in most public utilities there is relatively little; yet trucks and busses and automobiles offer such effective competition to our railroads that the latter would have to be cautious about raising rates, even if they were permitted to do so. Street railways and bus lines in some cities face the same problem because of the effective competition of taxis.

A monopolist, moreover, is likely to consider public opinion and the possibility of regulation in setting his price, for if he is wise he will not want to arouse too great public hostility. There has been a change in the attitude of many monopolists in this respect since the days of Cornelius Vanderbilt's famous edict, "The public be damned!" Vanderbilt set the style for his generation; and for years afterward many railroads gave little thought to public opinion, with the result that they built up a public hatred and distrust that was expressed in hostile legislation and increasingly drastic regulation. The extortionate rates charged by electric light companies in some cities have brought municipal ownership; and it may well be that the high rates for telephone service will some day cause the people to demand really effective regulation or public ownership.

For yet another reason, a monopolist may not take full advantage of his monopoly position. Once having achieved his position of monopoly, even though his means were not wholly ethical, he may have some sense of social responsibility, some desire to be of service and to be well regarded by his business associates and by the public generally, which may prevent him from exploiting his position to the greatest possible extent. As Marshall said: "A man may have used fierce, and possibly even somewhat unscrupulous, methods of combat, while still uncertain of success; and yet, when he has fully attained great wealth and power, may perhaps use these chiefly as means by which he can earn the respect of others and of himself. Instances of this, while not rare in old countries, are specially conspicuous in America; and they appear to be contributory causes of the tendency of some trusts, which have led troubled courses in early days, to take on a milder character, and to act with more careful regard to the interests of the public, when they have once attained almost irresistible power."[2]

Monopsony: monopoly in buying

Up to this point in this chapter we have considered monopolistic situations in selling. This is much the most important aspect of monopoly, but it is not the only one, for there are also monopolistic elements in buying. The situation in which there is a single monopolistic buyer is called *monopsony;* that in which there are two buyers is called *duopsony;* and that in which there are several buyers is called *oligopsony.*

While buyers as a rule are more numerous than sellers, "mass buyers" have become increasingly important in recent years. Such great corporations as Ford, General Motors, the tobacco companies, the mail-order and chain stores—in fact, a great many of our giant enterprises—that sell their products to a host of small buyers are on the other hand buying materials and supplies from sellers much weaker than themselves, in some cases, as in the case of the tobacco companies, from thousands of small producers. The meat packers, the grain elevators and creameries that buy grain and milk from farmers, linseed oil mills, fruit and vegetable and milk canneries, buyers of hides and furs from local trappers all have monopsonistic or oligopsonistic power in buying, and determine within limits the prices that they pay. In hiring laborers, some firms are in a strongly monopsonistic or oligopsonistic position. In some steel, coal, and textile towns, for example, there is only one important buyer of the services of labor, and in many towns there are only a few.

In buying from competitive sellers, a monopsony, like a monopoly in selling, sets its price at the point which will yield maximum profits. It must face the fact that the lower this price, the less will it be able to buy. Its cost curve for raw materials and for labor has some elasticity, because the producers from whom it buys do not have to produce and sell a fixed amount of the particular good, regardless of the price offered. Farmers, for instance, do not have to sell their butter fat to the local creamery; they may churn their own cream and sell the butter, or sell raw milk, or reduce the production of milk or give it up completely. Farmers who produce tobacco will not sell a fixed amount to the company buyers at all prices; they will produce and sell more at higher prices and less at lower prices. If low prices persist, some of these farmers will turn to the production of other crops. The linseed oil monopoly has at times set the price of flax so low that some farmers turned to other crops, with the result that the monopoly was forced to curtail its operations drastically. An isolated textile mill in a southern town may offer the only market for local labor, but if it sets the wage too far below the level of other labor markets, some laborers will move to areas where higher wages are paid.

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[2] Alfred Marshall, *Industry and Trade,* 3rd ed., p. 527. By permission of The Macmillan Company, publishers.

If the monopsonist is a purely competitive *seller* of his product—an unusual case—his average revenue curve is perfectly elastic and he can therefore sell a small output at the same price as a large output; but if, as is far more likely, he is to some extent a monopolist or a monopolistic competitor in selling his product, his average revenue curve will slope and he will be able to sell smaller amounts at higher prices. Thus he has a double incentive to restrict production—higher prices and lower costs.

Some monopolies deal monopolistically in both buying and selling, extracting their monopoly profit by widening the spread between the buying and selling prices, the latter perhaps covering also a processing charge. To the extent that the packers constitute a monopoly, they make their monopoly profits in this way. A better illustration, however, is the grist mills which once flourished in this country; they were local monopolies, buying grain from the farmers and selling flour, shorts, and bran to consumers in the surrounding country, or in some cases grinding the grain for a toll. It might seem that any monopoly would be in a position to exploit its advantages both as buyer and as seller, but its power is not necessarily great in both functions. As a buyer of raw materials it may buy from other monopolies, or it may buy so small a proportion of the total production as to have little power to beat down prices. Likewise, as a seller it may sell to other monopolies or to powerful business concerns that can meet it on equal terms. For instance, the United States Steel Corporation sells much of its output to railroads and to the Pullman Company, both of which are monopolies; it also sells to automobile manufacturers, the largest of which are strong enough to bargain on the threat of building their own steel mills. The Pullman Company, a tight monopoly, deals with the steel manufacturers on the one hand, and with the railroads, another class of monopolists, on the other. When one monopoly deals with another monopoly, the price fixed will depend on the relative strength and strategic position of the two monopolies.

Monopoly and joint products

A monopolist who controls the output of a joint product is subject to the same general principles as any other monopolist; he adjusts his output at the point of maximum monopoly profits—at the point where marginal costs equal marginal revenue. But there are certain peculiarities in conditions of supply which should be noted. The supply of a joint product, such as cottonseed oil, depends on cost conditions not merely of the oil but of the parent product, the cotton crop. It will be remembered that the costs of production of a joint product, and therefore its long-run normal price, can be determined only within wide limits. Let us assume, however, that a monopolist who controls the processing and sale of cottonseed oil buys the entire output of cotton seed. His supply will be highly inelastic; higher prices will not cause much increase, nor lower prices much reduction, in the amount of cotton seed produced. He is in a monopsonistic position in buying, and he will have the power to keep the price paid to the ginners below a competitive level. The inelasticity of supply of joint products is thus a factor which tends to raise monopoly profits. Our theoretical analysis fits the facts of the cottonseed oil business fairly well, for the 500 cottonseed mills are organized in a trade association that is rather effective in buying from the 12,000 ginners and in setting the prices of cottonseed oil products.

Regulation of monopoly price

In the preceding chapter we considered some of the difficulties in the way of regulating competitive prices. We saw that the government could not fix prices above or below the equilibrium level without in some way regulating the amounts demanded or supplied. The regulation of monopoly prices, however, presents a somewhat different problem. The monopolist often makes monopoly profits, and a government-fixed price below that which formerly yielded the maximum monopoly profits may not reduce production at all; on the contrary, it may even force the monopolist to expand production. This is shown in Fig. 33,

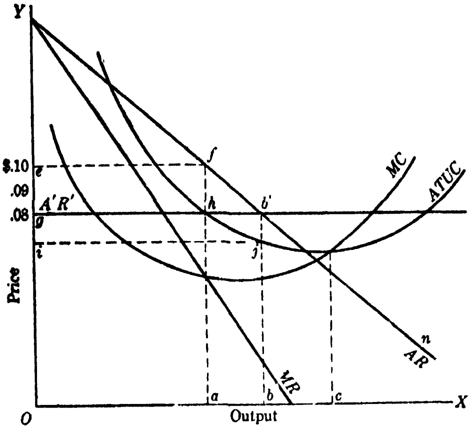

Fig 33. Regulation of Monopoly Price.

in which we have a monopolist selling let us say aluminum at 10 cents a pound; like any producer, competitive or monopolistic, he fixes his output at point *a*, where his marginal costs equal his marginal revenue, and he makes a profit represented by the area *gefh*. If the government fixes the price at 8 cents, it imposes on him a new average revenue curve, a line that is horizontal from *g* to *b'* and then slopes down to *n*. Between *g* and *b'* the monopolist can gain nothing by restricting production, because his price is now 8 cents, no matter how much he produces. From *b'* down to *n* on the *AR* curve he must sell at declining prices, because consumers will buy more than *b'* only at lower prices. If he produces *Oa* units as before, he will make no profit, if he produces *Oc* units—to the point of lowest average total unit costs, like a purely competitive producer—his average total unit costs will be above his average revenue and he will be losing money; but if he produces *Ob* units he can make a profit of *igb'j*, because his average total unit costs decline from *h* to *j*, yielding him a profit of *b'j* on *gb'* units, or *Ob* units on the *OX* axis. This is less than his former profit. This solution will of course be different if the curves are drawn differently, and we can never be certain as to how they should be drawn; but with cost and revenue conditions shown here, fixing the price of aluminum at 8 cents will force the monopolist producer to expand production but will not take away all his monopoly profit.

QUESTIONS

1. "There is no pure monopoly." Do you agree? What about a patent? Does it have to compete with anything?
2. Agricultural production is almost purely competitive, whereas all urban industry is more or less monopolized. What are some of the results of this?
3. "As soon as the Standard Oil Company got control of the Wyoming oil industry, the law of supply and demand was abrogated." Discuss the logic of this.
4. Explain how the East India spice growers could afford to destroy part of their crop. Could American cotton growers afford to do this if they were strongly organized? Could the Armour Packing Company afford to destroy part of its meat products?
5. If one man could get control of all the wheat production, where would he fix the output? Could he make wheat farming profitable?
6. Define monopoly profit. Is it *pure* profit? Why does monopoly profit persist in the long run, whereas competitive pure profit tends to disappear in the long run?
7. Why is there no fixed cost curve in the long run?
8. What does the elasticity of demand have to do with monopoly profit? What influence does elasticity of supply have? Draw graphs to illustrate your answer.
9. "To the extent that a concern advertises, its position appears to be competitive rather than monopolistic." Do you agree? Is this true of the cooperative monopoly that markets and advertises Sunkist oranges?
10. The Kansas Industrial Court found that all the coal dealers in a certain town charged the same price for coal. Was this evidence of an agreement as to prices?
11. A monopolist, like a purely competitive producer, adds units of output to the point where

his marginal cost equals his marginal revenue. Wherein, then, lies the difference between the two? Why is monopoly price nearly always higher than competitive price?

12. In what markets are there many more sellers than buyers? Describe the price-fixing process when a monopsony buys from many small sellers.
13. What factors might keep a monopolist's costs of production higher than those of a competitive producer? What factors might make them lower than those of a competitive producer?
14. "Monopoly control of products for which there is a joint demand often presents a serious problem." Why? Give illustrations of the problem.
15. "It is possible to regulate monopoly price in such a way as to give the monopolist an incentive to increase production and yet leave him some monopoly profit, if that is deemed wise." Draw a graph showing how this might be done.

Chapter 18.

Monopolistic Competition and Price

Classification

We have now considered long-run price determination in pure competition and in monopoly. In pure competition, it will be remembered, there are so many buyers and sellers of an identical product that no single buyer or seller has any appreciable control over the price; while in monopoly one seller controls the entire supply and the price, and in monopsony one buyer controls the entire demand. We come now to the situation intermediate between these; this is known as *monopolistic competition* and it appears in three forms on the sellers' side: (1) *duopoly,* in which there are two sellers; (2) *oligopoly,* in which there are only a few sellers of an identical or nearly identical product, so few that each may have some control over the price but that in setting his price each must consider his rivals' possible reactions to the price; and (3) *product differentiation,* in which there are many sellers offering products which are similar but not identical. The sale of wheat represents almost pure competition; the sale of electric power represents about the closest possible approximation of pure monopoly to be found in industry; the sale of locomotives represents duopoly (unless we believe that the two producers have some sort of monopolistic agreement, which would make it really monopoly); the sale of automobiles represents oligopoly; and the sale of the various kinds and brands of cereal foods represents product differentiation. These different market situations are not sharply distinguished, for each shades into the other and there is much overlapping. Most of them appear in buying as well as in selling; but our discussion will be confined largely to the selling side of the market.

Monopoly, duopoly, oligopoly, and product differentiation present one characteristic in common: they all involve *some* monopoly power, some power of the seller to control his output and price. On the other hand, they all involve *some* competition, for the tightest monopoly faces some competition, and oligopolists and producers of differentiated products may find it very severe. But there is one clear difference between monopoly, oligopoly, and product differentiation on the one hand, and pure competition on the other. In the former, the producer sets or *administers* his price, whereas the pure competitor dumps his product on the market for whatever it will bring. The aluminum monopoly, the Standard Oil Company, the producer of Corn Flakes or Schick Razors or Yello-Bole Pipes, the merchant, or jobber, or wholesaler—all these sellers set prices on their products and try to sell at those prices. Only the (almost) purely competitive farmer—the wheat or cotton farmer, for instance—or the seller at an auction dumps his product on the market for what it will bring. Here we encounter the common distinction between *administered* prices and purely *competitive* prices. The distinction assumes particular importance in times of business recession, for administered prices change slowly, while purely competitive prices are likely to be in constant fluctuation; and in such a period, when prices are falling rapidly, this difference creates a serious maladjustment between the two segments of the economy.

Duopoly

Duopoly is a market situation in which there are two producers of an identical or nearly identical product who are bound by no agreement as to price or output. Two companies control most of the output of a number of products: electric motors, electrical equipment, grain and rice and corn binders, synthetic nitrogen, locomotives, and sulphur, among others; but it can hardly be assumed that there are no agreements as to price or output in these industries, for such a situation almost inevitably results in some form of price or production agreement, or perhaps in tacit price leadership. If one producer cut the price, the other would almost surely have to follow; but it is difficult to see why either should start cutting, because each should know that the other will follow, and the result will be loss for both. It is conceivable that one might want to drive out the other and might start a price war with this intent, but the end of this process would be monopoly. Thus, in one way or another, duopoly almost certainly becomes monopoly.

Oligopoly

Oligopoly prevails where only a few concerns control the production and sale of identical or nearly identical products. To illustrate, there are some 121 products, some of them very important products, in whose manufacture the four largest producers control more than three-fourths of the nation's total production. This is a common situation. The merchants in many small and moderate-sized towns present a situation resembling oligopoly, for only a few firms sell each general class of merchandise. The essential characteristic of oligopoly is that *there shall be so few producers that each of them has some influence over price but cannot ignore the reaction of his rivals to the price he sets.* Any one of the producers of sugar or cigarettes or matches can set his own price within limits; but in doing so he must consider his rivals' reaction to it. He may be tempted to cut prices a little, for if he can do it without retaliation he might increase his sales considerably; but of course he has to consider the possibility that his rivals might meet his cut, in which case he will receive a lower price for the same proportion of the sales as he had before. If he has stronger financial reserves than his rivals, he may not be averse to a price war in the hope of driving them from the field, but the struggle will be costly; furthermore, if, after securing a monopoly position, he tries to exploit it by raising prices too high, he may bring in other competitors, if there is reasonably free entry to the field. He may indeed try to cut prices secretly, through hidden rebates or other concessions to buyers; but such tactics can seldom be kept secret; and once known to his rivals, secret cuts are likely to have the same effect as open price cuts. Secret rebates and concessions were once fairly common, but in recent years trade associations have tried hard to suppress them.

Much will depend on cost conditions of the oligopolistic producers, whether they are operating at increasing, constant, or decreasing cost. If they are operating at increasing cost, they will be less anxious to expand production than if they are operating at decreasing cost, and therefore will be less likely to cut prices. If one producer is definitely stronger than the others and produces enough to secure lowest cost, he may not care to enter into price competition, may prefer to let well enough alone; the others may not dare to start price cutting, even though they are operating at decreasing cost and would like to have more business. The price is more likely to remain stable if all the producers have reached lowest cost than if the output of some or all of them is not sufficient to bring lowest cost.

If the product is not identical for all the producers, competition may take the form of advertising, which is less likely to bring quick retaliation than a price cut; but if one advertises, the others are likely to be forced to do likewise. In this case all will lose, just as they will from price cutting, but the loss will take the form of higher costs, which must now include the advertising, instead of lower prices; and higher costs will probably mean higher prices to the public. Even if the product is practically identical for all producers, one or more may try to build up *imaginary* differentiation by advertising, as cigarette manufacturers and oil companies do.

Just where oligopoly price will finally be fixed is impossible to say. It depends on the number of oligopolists, on their cost situation, on their willingness to adopt a friendly, cooperative attitude—as shown, let us say, in the avoidance of price cutting—and perhaps on the strength of their trade association, for trade associations often try to prevent price cutting and sometimes have strong influence. The price may be as low as purely competitive price. The few great tire manufacturing companies have competed aggressively, and their prices have been little if any above a purely competitive level. On the other hand, oligopoly price may be at the level of almost pure monopoly price. It will be found somewhere between these two extremes.

The price set in an oligopolistic situation may depend largely on the personal attitude of one strong producer in the group. The rubber tire industry, although highly concentrated in a few powerful firms, has been vigorously competitive, and the prices of tires have declined steadily while quality has improved at an amazing rate, to some extent because of the personal business philosophy of Harvey S. Firestone, a friend of Henry Ford and an advocate of the policy of increasing volume of output by reducing prices. Far from being a "cooperator," he was a rugged individualist who persistently played the lone wolf; he cut prices whenever he felt like it, perhaps because he thought it a good long-run business policy, or partly, perhaps, because of a genuine desire to offer the best possible service to consumers. Another reason for vigorous competition in the tire industry is the fact that large-scale buyers play an important role in the market. Automobile producers buy about one-fourth of all the new tires produced; Sears, Roebuck & Company, Montgomery, Ward & Company, the big oil companies, and some other mass distributors like the Western Auto Supply Company also buy large numbers of tires, and these concerns are of course in a position to bargain with the tire manufacturers. If it had not been for Firestone, however, the tire manufacturers might well have combined in a pool or gentlemen's agreement for the specific purpose of fighting these powerful buyers.

Active competition in the automobile industry, until about 1929, was likewise due partly to another dominating personality, Henry Ford. Other manufacturers would have been glad to "get together" and make some easy money by setting stable and remunerative prices for cars, but for years Ford refused to cooperate; instead, he cut prices again and again. One General Motors executive complained of this in 1934: "Mr. Ford, who won't play, is pretty much the price setter in this industry. I'll bet if Mr. Ford's cars were $50 higher, ours would be $50 higher. We care about Ford. We have been struggling with him for years." Ford's independence, as the Federal Trade Commission reported, "has been a keen disappointment to other more cooperative-minded motor vehicle manufacturers in the industry, particularly in the low-price field, for it compelled them to price their cars lower than otherwise might have been the case."[1] There is some reason to believe that Ford has been a little more cooperative in recent years, for price cuts have been uncommon and the industry has settled down to a fairly stable condition, adding nickel trim or inconsequential gadgets rather than improving cars or cutting prices. Ford's more cooperative attitude may be partly due to the fact that his business has been far less profitable than that of some of his important competitors. In five of the ten years between 1927 and 1937, he showed a deficit, which of course put him in a poor position to wage any aggressive economic warfare.

The most common outcome of an oligopolistic situation is some form of price agreement, that is, monopoly. The ordinary concept of oligopoly assumes that there are no such agreements; but for the same reason that two producers of an identical or nearly identical product almost inevitably establish some sort of price agreement, three or four or a half dozen or more producers are likely to do the same thing. If the product is identical, a price reduction by one producer will cut sharply into the sales of the others, and they will be forced to meet it; this means that an agreement will be reached before anyone starts such an unbusinesslike procedure. In some cases price leadership has been adequate to prevent price cutting.

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[1] Temporary National Economic Committee, *Monograph No. 21*, p. 197.

Product differentiation

The third form of monopolistic competition, and the most important, is product differentiation, and it is this form which calls for most of our attention. It is so important that when the term monopolistic competition is used hereafter, it will refer to product differentiation.

Here are included products differentiated by actual peculiarities of the products themselves, in quality, design, color, or style; in patents, brands, or trade-marks; in the kind of packages or containers; or in conditions surrounding their sale, such as the location and type of the shop, the delivery service, credit facilities, and character of the salespeople employed. Products are differentiated, as Chamberlin says, "if any significant basis exists for distinguishing the goods [or services] of one seller from those of another."[2] An identical product may thus be differentiated if it is sold under conditions that differ in any way; the Post Toasties sold in an Atlantic and Pacific store may be "different" from the Post Toasties sold in another grocery store. Identical products may be differentiated if buyers *believe* them to be different. Tests made with blindfolded smokers have proved that Old Gold, Lucky Strike, and Camel cigarettes are practically identical, yet for our purpose they must be considered differentiated, because many people believe that they are different and prefer one brand to the others. So too were the mattresses differentiated which a certain company made exactly alike, but sold at different prices with different labels.

From all this we can see that almost all manufactured products are differentiated, because almost all of them carry differentiating trademarks or brands. If the student will wander through any retail store he will find trademarks or brands on almost every product, perhaps with flamboyant claims of superiority in one or more respects. Ford cars, General Electric refrigerators, Schick razors, Cannon towels, Waterman fountain pens, Carnation canned milk, Bayer's aspirin, Old Gold cigarettes—all these are sold under monopolistic competition, as are *all* the goods sold by Marshall Field or Wanamaker or the corner grocery store.

Product differentiation and monopoly

The producers of differentiated products are monopolists with respect to their own patented, trade-marked, or branded products. Like true monopolists, they can sell at whatever prices they think will yield them the highest net revenues. There is, in fact, no clear and precise distinction between monopoly and monopolistic competitions, but three hazy lines of distinction may be drawn. In the first place, the monopolist often controls an industry, whereas the monopolistic competitor typically controls only one branded or trade-marked product. The aluminum monopoly, for instance, controls the aluminum industry. If there were a hundred producers of aluminum of various grades and of aluminum products, they would be considered monopolistic competitors if they were really in competition with each other. The producer of Post Toasties is a monopolistic competitor; but if the Post interests controlled the entire cereal food industry it would be classed as a monopoly. This distinction is to some extent valid, yet the distinction between an industry and a product is vague. There is no precise definition of an industry. Triffin insists that the concept is useless for analytical purposes, because in the case of a given product competition comes not only from other products within the industry but from products in many other industries.[3] Myers takes a somewhat similar view in recognizing that Corn Flakes may meet competition from a vast number of other products, including many that are outside the cereal food industry and even outside the food industry itself.[4] Much of the competition in our present economy is between industries rather than products. Monopoly-controlled aluminum has to meet the competition of many other metal alloys, electric current faces competition from natural gas in some of its uses, brick competes with lumber in house construction.

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[2] Edward Chamberlin, *The Theory of Monopolistic Competition*, 3rd ed., p. 56.

[3] Robert Triffin, *Monopolistic Competition and General Equilibrium Theory*, pp. 88, 89.

[4] Albert L. Myers, *Elements of Modern Economics*, rev. ed., p. 90.

In the second place, the distinguishing feature of monopoly is often said to be the absence of freedom of entry, as against the freedom of entry in monopolistic competition. The Aluminum Company of America, through the ownership of patents and certain raw materials, controls the aluminum industry, there is practically no freedom of entry into that industry, and it is therefore a monopoly; whereas there *is* freedom of entry into the cereal food industry, which is therefore said to represent monopolistic competition, although there is no freedom of entry into the production of Post Toasties or Quaker Oats. The distinction seems valid but blurred, for, as was just said, it is difficult to define an industry as opposed to the manufacturer of a product. Aluminum represents a product as well as an industry, as do copper, steel, lead, zinc, tungsten, sulphur, nickel, and Pullman cars. A further difficulty with the distinction based on freedom of entry is that the phrase itself is vague. How little freedom of entry must there be to make an industry a monopoly? In the case of public utilities, there is *no* freedom of entry; in the case of an industry dominated by a powerful monopoly like the Aluminum Company of America, buttressed as it is through the ownership of patents and bauxite and its vast financial resources, there is *practically no* freedom of entry; in the steel industry, where it would cost around $100,000,000 to build an efficient plant, it would be *difficult* to enter because of this heavy initial investment; yet a few new concerns have grown up right under the nose of the mighty United States Steel Corporation. Similarly, in the production of cosmetics, branded drugs, and patent medicines, there is no impassable obstacle to entering the business, but the initial investment required to advertise and build up a market for a new patent medicine is so great that new producers do not enter in sufficient numbers to eliminate the princely profits earned in the industry; in the retail business, on the other hand, entry is free and very easy, for the initial investment is small. Freedom of entry is thus a vague concept, it is always "more or less"; yet it is a concept of fundamental importance. Monopoly profits can be maintained only to the extent that competitors can in some way be kept out of the field. To the extent that there is freedom of entry, there can be no continuing monopoly profits.

A third distinction between monopoly and monopolistic competition is the fact that generally there are less acceptable substitutes for monopolized products than for products which are monopolistically competitive, and that the monopolist faces a more inelastic (more nearly vertical) demand curve and therefore has a stronger incentive for restricting production. For most uses, there is no close substitute for city water, electricity, telephone service, oil products, steel, glass containers, typewriters, wheat harvesters, spectacles, cameras; but for *Ford* cars, *Lucky Strike* cigarettes, *Chancellor* cigars, *Wade and Butcher* razors, and *Pebeco* tooth paste there are rather close and acceptable substitutes, and the range of possible price increases is correspondingly narrow.

With respect to the availability of substitutes, the slope of the demand or average revenue curve, and the incentive to reduce output, monopolistic competition occupies a position midway between pure competition and monopoly. In pure competition, there are *perfect* substitutes for the product of any individual producer, the average revenue curve is *perfectly elastic* (horizontal), and the producer therefore has *no* incentive to restrict production; in monopolistic competition, there are *fairly satisfactory* substitutes for the product of any producer, the average revenue curve slopes *moderately*, and as a result the producer has *some* incentive to restrict production; in monopoly—as near to pure monopoly as can be found—there are *no* really satisfactory substitutes, the demand or average revenue curve slopes *more steeply*, and therefore the monopolist has a *strong* incentive to restrict production. In all cases the amount produced and the price are of course determined by the intersection of the marginal cost and marginal revenue

Product differentiation and profits

Since monopolistic competition occupies a position midway between pure competition, where there are no pure profits, and monopoly, where there are often high profits, it might appear that there should be *moderate* profits in monopolistic competition, profits somewhat of the nature of monopoly profits, since each producer of a differentiated product is a monopolist with respect to his own product. There are various reasons, however, for believing that there can be little if any monopoly profits in monopolistic competition. Some monopolistic competitors do make handsome profits, even more than most monopolies; some make reasonable earnings, perhaps a little above wages of management; but others, doubtless the greatest proportion, struggle along for a while at a loss, and then disappear. In the retail business, for instance, some of the chain stores have earned an average of 25 per cent for years; some of the department stores and many of the small retailers have made no pure profits but have earned enough to cover expenses, including wages of management; but many retailers operate at a loss and finally, in a few years on the average, abandon the field. In the automobile industry, Ford and a few others made huge fortunes, while several hundred others failed; although a few made fortunes in the tire business, of more than 500 companies that manufactured tires at one time or another, only 26 were still in business in 1937. Some years ago there were about 600 manufacturers of trailers, but today nearly all of them have disappeared. Presumably not all of those who failed were entirely wiped out, but most of them undoubtedly lost something, and many lost heavily. It is easy to underestimate the losses in business because the examples of high profits are still before us, while the derelicts are no longer buying pages in the *Saturday Evening Post.*

Strict reasoning leads logically to the conclusion that there can be no general monopoly profits in the manufacture of differentiated products. The individual producer has a monopoly of his brand only, not of all brands, and is therefore not in the position of a true monopolist. He faces competition not only from other brands of the same good but from other goods as well. He has to meet competition in price, in quality of product, in service in some cases, and in advertising. If he makes very large profits, other producers may try to imitate his product, unless he has a patent covering some process essential to its manufacture—in which case he is of course a monopolist. Even if he has such a patent, other producers may try and may be able to produce something similar and equally attractive to consumers. If an industry offering reasonable freedom of entry earns exceptionally high profits, businessmen will probably invade it and bring these profits down. There is, however, some evidence that this process does not work very accurately. The patent-medicine business, for instance, appears to be highly profitable; but, if true, this indicates that there are many irrational or even slightly stupid businessmen who do not know enough to enter a profitable business.

A monopolistic competitor may build up a wide market for his product in various ways: (1) by cutting prices, (2) by offering a particularly high quality of goods or services, or (3) by advertising or salesmanship. Examining these in turn, we shall find that monopoly profits cannot generally be secured through any of these policies.

Price cutting

Aggressive price cutting characterizes severe competition—although not pure competition—rather than monopolistic competition; and it does not seem to be an obvious means of gaining monopoly profits. Even if buyers were keenly price-conscious, price cutting by one competitor would be likely to lead to widespread price cutting, with a loss to all, unless the total market expands sufficiently to compensate for the cuts. The business world is generally hostile to price cutting, although a few concerns have amassed great profits through this policy. Ford and Firestone have already been mentioned in this connection; the chain stores and the great mail-order houses have earned huge profits by this procedure. Nevertheless, such profits have little element of monopoly in them.

Producing quality goods

Some monopolistic competitors have made handsome profits by making and selling goods of exceptional merit, but of course it costs more to make high-quality products than inferior products, and as long as the market for quality products is open to all, it is difficult to see how this policy could be unusually profitable. If it were, more producers would follow it and so reduce profits to the level prevailing generally in industry.

Common reasoning leads easily to the conclusion that the general use of trade-marks and brands puts considerable emphasis on quality, and even that it might be the essential condition for any great improvement in quality. At one time, all the fruit raised by many fruit growers was put together, graded into two or three classifications, and sold to the public with no identification of the producers. Then it occurred to some of these producers that they could get better prices if they could standardize their fruit at a higher quality and adopt a brand which would identify their product to consumers. Cooperative societies were established for this purpose, and the result was better quality as well as, probably, higher prices; but the improvement in quality could not have been made profitably without the brand. Somewhat the same story holds true in the production and marketing of milk, butter, eggs, cheese, and, in some instances, truck crops. Whether such methods actually raise prices to the consumer, quality considered, is doubtful; but certainly he can buy branded products with greater confidence as to what he is getting, and his relatively increasing purchases of them indicate that he prefers them. It may be significant that the quality of many goods has improved with the increase in the use of brands.

In saying that branded goods must generally have some merit, we mean merely that they must have qualities which consumers want and are willing to pay for. Volumes have been written to show how ignorant, irrational, stupid, and silly many consumers' desires are; how people will buy articles at a given price when they could get better articles for half or even one-tenth the price; how they will "prefer" one brand of cigarettes to another exactly like it, or one brand of coffee to another which is much better; how they will pay hard-earned dollars for pink pills and medicines which at best will not cure fifteen different diseases and at worst may cause new diseases. We may grant that most people are not well informed, are naturally more or less irrational, and some of them stupid, and that the advertisers have created some special brands of irrationality for their own purposes; but whatever the rationality of the wants, and however they may have arisen, the seller must satisfy them if he is to prosper. Goods must have the kind of merit that the consumers demand; and it is difficult to see how producers could *generally* make more profit selling to irrational than to rational consumers. Consumers are prey equally to all who would exploit them. There is no closed season for them, and no one has a monopoly of the business.

Advertising

Turning now to the case of a favorable position secured by advertising alone, we find that again monopolistic competitors cannot ordinarily make monopoly profits. A producer may indeed employ advertising to build up a wide market for a brand of no particular merit; but as a matter of logic he should be able to reap only enough returns to pay the cost of the advertising. If advertising yielded monopoly profits generally, producers would resort to it more, for it is available to all. It is an elementary principle in advertising strategy, furthermore, that the producer who is planning an expensive campaign should have something that will please, for otherwise he is likely to be building on sand. It is easy to see, for instance, that if Procter and Gamble had spent their millions in advertising a brand of soap that women soon found unsatisfactory, they would have lost much of their money. The history of national advertising is a record of a few notable successes and many failures; and many of the failures were due to the fact that the advertised brands either did not meet popular approval or eventually lost it. A wise producer will weigh the relative advantages of raising the quality of his product and increasing his advertising budget, and he will spend money for each until the last expenditures bring just enough sales to pay their cost—until marginal returns balance marginal cost.

Rationality and monopolistic competition

To what extent is the monopolistic competitor likely to use each of these three weapons of competition: price cutting, quality improvement, and advertising? Or, since price cutting and improvement in quality really amount to the same thing, we might better ask: To what extent will the monopolistic competitor use price cutting and quality improvement, and to what extent will he use advertising? The question is very important, for price cutting and quality improvement are ways of giving the buyer more for his money, whereas advertising is a means of getting his business without giving him more for his money.

To the extent of consumer knowledge and rationality, the producer will find it profitable to keep prices down or quality up, for rational consumers appreciate low prices and high quality and will buy goods which are cheap or good, or both. *To the extent of consumer ignorance and irrationality,* on the other hand, the producer will be induced to advertise, for ignorant and irrational consumers are more likely to be won over by advertising than by low prices or high quality, which they are unable to appreciate. The high prices and persistent advertising of many differentiated products are unmistakable proofs of consumer ignorance and irrationality, for if consumers appreciated the real values of goods, any producer who cut his advertising expenses and devoted the saving to lower prices or better goods would take business away from the producers who advertise.

If there were many producers of differentiated products, if all consumers were perfectly informed and rational—that is, if they knew all about the differentiated products offered for sale and were rational in appraising them—and if there were a single objective criterion by which the different brands could be rated, the market for differentiated products would differ little from that for identical products; in other words, it would differ little, if at all, from a purely competitive market. If, for instance, there were a thousand producers of men's socks, if consumers knew exactly how long each brand would wear, if they were perfectly rational in using their knowledge, and if they rated socks only according to relative durability, the market for socks would be much like that for wheat, and no producer would have any control over his price. Socks that wear a month would sell for half as much as those that wear two months, and every brand would sell for cost of production, for if any producer tried to raise his price above that level he would not be able to sell any socks at all.

The market for differentiated products is not purely competitive, however, because buyers are not perfectly informed and rational and because there is no single criterion for judging such goods. Sometimes a producer may lower the quality of his product or raise the price without an appreciable loss in sales, particularly if he advertises his goods skillfully. Or, on the other hand, he might improve the quality of his product or lower the price without winning any considerable increase in sales.

The market for differentiated products also deviates from pure competition because there is no single criterion for appraising such products. In discussing the market for socks, we assumed that the socks were rated for wear alone. It is possible to compare them on this basis alone; but we shall come nearer to actuality if we recognize that, in addition to durability, socks may be valued for style and appearance, comfort and warmth, and that different buyers will vary in weighing the different qualities. Here we have lost our single criterion of appraisal, and even if buyers were perfectly informed and rational, they would still rate various brands differently. A producer who raised his price would lose some but not all his sales, because some buyers would still prefer the particular combination of qualities offered in his product. He would have some control over his price, but not much if his customers were perfectly informed and perfectly rational.

High cost of marketing in monopolistic competition

We have seen that a monopolistically competitive producer usually gains no monopoly profit. The evils in the production and marketing of differentiated products are to be found not in monopoly but in high costs.

The best way to explain the high costs of producing and marketing differentiated products is to use a hypothetical illustration, artificially simple. Let us suppose that competitive producers sell only one cereal food, oatmeal, of uniform quality, in uniform packages; and that there is no competition between this cereal and other foods or products of any kind. With only one uniform cereal produced, consumers may be assumed to know exactly what oatmeal is like, for it is not difficult to learn about one such commodity. The producers will have no problem of selling, no advertising or salesmanship. Let us assume that ten competing plants produce the amount required, each plant operating at lowest internal costs, and the industry enjoying some external economies from the operation of so many plants. The producers sell at a price that covers only costs of production. Here we have most of the assumptions of pure competition.

Now let us assume that nine of the ten plants shift to the production of nine other different kinds of cereals, with the result that ten cereals are sold, instead of one. This change will have various results. In the first place, since only one plant now produces oatmeal, it will lose the external economies that it previously enjoyed, and the costs of manufacturing oatmeal may be higher; and perhaps none of the nine other cereals can be manufactured quite as cheaply as oatmeal formerly was. In the second place, the costs of marketing ten different products will certainly be higher than the costs of marketing ten times as much of one product. Every store will have to stock ten products instead of one; this means an increase in its investment, a decrease in turnover, an increase in loss from spoiling, and some increase in clerical expense. In addition, the producers will have a greatly increased expense in "establishing connection between the products and the consumers." The consumers must now know something about ten times as many cereals; and this, under any conceivable system of marketing, means increased expenditure of time and energy on their part, and increased expense to producers, because each producer must inform consumers about his particular cereal, and the costs must be spread over an output only one-tenth as large as the original production of oatmeal.

Let us assume now that each of the ten producers decides to produce two different cereal foods instead of one, with a resulting doubling of the number of products. This will result in reducing the output of each plant 50 per cent, perhaps to a point where it can no longer enjoy even maximum internal economies. Manufacturing costs may be raised for the cereal products formerly produced, and the costs of the new products may also be high. The costs of marketing, including advertising, will rise again, because merchants' stocks must be larger and more connections must be established.

We now bring this example nearer reality by taking away the hypothetical fence that we built around the cereal food business. Let us assume that in most other fields of industry the number of differentiated products has multiplied just as it has in the cereal food industry; that all the thousands of producers—of cereal foods and canned goods and bread and candy and tobacco and beer and whisky and summer drinks and medicines and clothes and tires and automobiles—are fighting for the consumer's attention and for his dollar, and we have some idea of the problem of marketing differentiated products in the modern age. Of course it is expensive. Even a small proportion of all the selling connections indicated here is a bit like a telephone connection in New York City. Indeed, the selling of goods, broadly considered, is somewhat like the telephone business—conducted at increasing cost as the number of products is increased.

Against the higher costs of selling must be set whatever gain consumers may derive from the fact that such a multiplicity of goods enables them to secure the exact satisfaction that they desire. They do not all have to eat oatmeal, and those who like oatmeal do not have to eat it all the time but can have a new kind of predigested cereal food almost every morning in the year. According to the principle of diminishing marginal utility, this should result in a moderate gain in human happiness. Even when advertisers create a demonstrably irrational want or raise the consumers' irrational valuation of a certain product, this may be to some extent a productive service. Men who smoke cigars advertised as being made without spit may well gain an extra utility sufficient to pay for the advertising, even though other cigars are quite as sanitary; buyers of the *Book of Knowledge* may well be happy in the firm confidence that they will some day hold the board of directors spellbound with their wide information; buyers of Lifebuoy soap and Listerine may well be serenely happy in the knowledge that they are free from B.O. and halitosis.

The foregoing analysis might indicate that advertising is not quite the villain it is often assumed to be, that the fundamental cause of the high costs of marketing is not advertising but the great multiplicity of differentiated products. But advertising is to some extent responsible for the multiplicity of products. To the long list of actually differentiated products it has added a great many imaginarily differentiated products and has exaggerated the amount of differentiation throughout the list. Any given grade of gasoline, for example, is much the same for all producers, but the advertisers have built up imaginary distinctions in Stanolind, Red Crown, Koolmotor, and Tailor-Made gasolines; there are several actually different kinds of cigarettes, but the advertisers have "created" additional kinds. Perhaps half of the differentiated products commonly sold have been "created" by their advertisers.

Not only have advertisers increased the number of necessary connections between differentiated products and consumers—increased the number of telephone connections, to continue our analogy—but in many cases they have established the connection badly—given us the wrong number. Sick people have been connected with Lydia Pinkham's Pink Pills instead of a competent physician; bald men have been informed of hair restorers instead of toupees; ambitious boys have bought sets of books that made them talk like fools instead of thrilling the board of directors. All this is inevitable, the advertising business being what it is. Advertisers are mainly interested in selling goods, not in disseminating truth. Unlike the telephone operators, who try to give us the numbers we really want, the advertisers try to make us want the numbers they represent. It is only fair to say, however, that in this respect the advertising business is but a logical agency of laissez-faire capitalism. A producer with goods to sell will try to sell them, and he cannot be expected to be too punctilious as to the accuracy of his representations, for if he were, he might not sell his goods and might soon cease to be a producer. The consumers are the final judges of all products and are assumed to be competent to judge well.

Advertising may increase the costs of goods in another way, as another hypothetical example will make clear. Let us assume that there are ten businessmen in a small, isolated community, each of whose total sales takes 10 per cent of the community's total expenditures, but that none of these men advertises.

Automobile dealer	10%
Gasoline station owner	10%
Grocer	10%
Druggist	10%
Furniture dealer	10%
Men's clothing dealer	10%
Women's clothing dealer	10%
Radio and electric refrigerator dealer	10%
Lumber dealer	10%
Banker selling bonds and investments	10%
	100%

Now suppose that the automobile dealer puts on an advertising campaign and increases his sales to 15 per cent of the community's total expenditures, taking the additional 5 per cent from the furniture dealer. The latter, who will now have only 5 per cent, will be induced to buy advertising space in the newspaper to bring his sales back to their original 10 per cent. If he succeeds, he must get 5 per cent from some of the other dealers—let us say from the men's clothing dealer (3 per cent) and the women's clothing dealer (2 per cent). Both the latter will now be obliged to advertise to get back the business they lost, and we shall assume that they are successful—at the expense of the automobile dealer (2 per cent), the radio dealer (2 per cent), and the lumber dealer (1 per cent). All these must now advertise; and the result will be that they take business from other merchants, who in turn will be obliged to advertise more. All these dealers might perhaps gain slightly by advertising, at the expense of the people's savings —the bank's sales of bonds, etc.—but this would in turn force the bank to put on an advertising campaign to get people to save more. The total result would be not an increase in the amount of business done, for the people cannot spend more than 100 per cent of their incomes, but a shift of productive labor from all the retailing businesses to the advertising business, higher costs of doing business for everyone, and a lower standard of living in the community.

But might not advertising have the effect of making consumers want more goods, of prodding them to work harder and produce more, in order to earn the money with which to buy more goods? Clearly it might; but against the increased energy thus induced would have to be balanced the loss of the labor and capital which were shifted from industrial production to the advertising business. It is impossible to say whether total production would be greater or less; and even if it were greater, there is no reason to assume that it would represent a social gain. When the whip of advertising drives men to work harder, earn more, and buy more goods, even though, if left to themselves, they would prefer leisure to more goods, there is reason to assume that the sum of human satisfactions has been reduced, for leisure is a good, too.

Such waste as we have just described is one of the wastes of competition, and it would appear in any competitive scheme of selling. Suppose, for instance, that a merchant in a town sought business by stationing a robust crier at each street intersection to shout the merits of his wares. This might bring increased trade as long as only one merchant played the game; but if it proved profitable, other merchants would also station criers on the streets, until, in the general clamor, the first criers' voices would be largely lost. It would be a noisy town —as noisy-*sounding* as the average magazine or newspaper, with all its screaming advertisements, is noisy-*looking*—and the merchants on the whole would sell no more goods than before; yet none of them would dare withdraw his crier, lest his name be forgotten.

Suppose that advertising were prohibited and we reverted to the custom of selling to retailers through traveling salesmen. In that case producers would be likely to compete in hiring more and better traveling salesmen, who to some extent would nullify each other's efforts just as the criers would, and as advertisers do. There would be a difference, however. Although the consumer buyers are the final arbiters as to different products, and advertisers work mostly on them, the drummers would sell to the merchants and dealers, who are more sophisticated buyers, more skilled in appraising goods, than the consuming public. Goods may have been more accurately appraised when producers sold through drummers, because they were appraised by more specialized and skilled buyers.

Advertising, particularly national advertising, has in some respects changed the nature of the retailing business. When goods were sold largely through traveling salesmen, merchants performed the functions of choosing such goods as they thought would please their customers, and selling them at retail. Today this is of course still true to some extent; but to some extent advertisers have taken from the merchant the function of choosing, have made consumers brand-conscious so that they demand certain brands of goods, and the merchant's only function now is to hand them over the counter. "Don't just ask for aspirin. Ask for *Bayer's* Aspirin." Many people do just that. In this respect the merchant's function is less important and less dignified than it once was.

There is yet another cause for rising marketing costs. The vast productivity of modern industry, the possibility of great expansion in the output of almost every product, has led to stress on selling, for an increasing output may have to be sold to more and more indifferent buyers. Let us use automobiles as an example. For some years Henry Ford was able to sell an increasing number of cars without difficulty, without any advertising at all. Buyers did not even have to be *sold* Ford cars; they *bought* them. Before the outbreak of the Second World War, any automobile manufacturer could have produced more cars than he could sell at the price he asked. Now many people would buy cars even if they had to sneak around the back alleys at night to find an automobile "speakeasy." Enough cars to meet such a demand could be sold at low marketing costs. But other people are not so anxious to buy, and to sell to them it may be necessary to employ moderately expensive salesmanship and advertising; still others will buy two cars each if more expensive sales campaigns are carried on; and at the fringe of sales possibilities are the stubborn folk who insist on driving their old cars or none at all, and who will buy only if they are coaxed and cajoled and harangued and inveigled and shamed into it. After a certain point is reached, more cars can be sold only to more and more indifferent buyers, and at higher and higher selling costs.

"Prospects" may be hard to sell for a variety of reasons: they may not want new cars very badly; they may have little money and would have to skimp on other things in order to buy a car; they may have been whipped into a strong desire for other things by the salesmen and advertisers of these other things. There are no game laws to protect prospective buyers; they are subject to a constant barrage of salesmen's talk and advertisers' suggestions from a hundred directions; and the producer who does sell them is likely to do so at considerable expense. Thoreau, who asserted that the world would beat a path to the home of the maker of a superior mousetrap, had never seen the modern marketing system in operation. The truth is that the maker of a good mousetrap would have to establish headquarters in a city, build up a sales organization, advertise widely, and sell his trap at a price which would cover all these costs—perhaps at a price two or three or four or five times the cost of making the trap. The consumer market is a private fishing pond, and the salesmen and advertisers have most of the fishhooks which they rent to those who would fish, and the rent of the fishhooks is one of the costs of production. To sell anything, a producer has to meet all the skilled sales talk and advertising of producers of other brands and other articles, which means high costs for all.

If producers could and would reduce prices enough, they could sell a large output without the fusillade of advertising which characterizes modern marketing; but, as we have seen, the business world is generally hostile to price cutting, and indeed to the general idea of price competition. Producers have a preference for such non-price appeals as advertising, attractive packaging, and improvement in quality, on the theory that consumer good will built up through such appeals is likely to be more enduring than that secured by price cuts which lose their appeal as soon as competitors have met them. Businessmen strongly resent price cutting—"chiseling," as they often call it. They regard it almost as a violation of business ethics. Advertising is not regarded as a vice in the same class of moral turpitude. Of course the newspapers help to build up the notion that it is something profitable, patriotic, and altogether good.[5]

Raising consumer rationality

Advertising, as we have seen, is profitable largely because consumers do not know all about the goods offered for sale, and are irrational in using such knowledge as they do have. If they knew everything about all goods and were completely rational in their thinking, they could not be swayed by gabble about "costlier tobaccos," "milder cigarettes," or "film-removing" dentrifices. Consumer ignorance is the advertisers' hunting preserve, and any rise in consumer intelligence would reduce the amount and cost of advertising, reduce the costs of marketing, and increase consumer satisfactions by enabling buyers to choose goods more intelligently. Even more important, it would bring great economies in the use of productive capital and labor by driving out the producers of spurious, inferior, and overpriced products. The producer of toilet soap who advertises heavily and sells 20 cents' worth of soap for $1.97; the manufacturer who sells for $80 a cleaner worth $30; the man who mixes a penny's-worth of germicide with some appropriate coloring material and sells the stuff for a dollar: these—and they are actual cases—would have to cut prices drastically if consumers were well informed; and the savings would of course be very great, much greater than the mere cost of advertising, which ranges from 1 to over 18 per cent of the price of the finished goods, with an average of around 3 per cent.

Some non-governmental agencies are trying to provide information for consumers and to protect them from the worst forms of advertising misrepresentation; among them are the Consumers' League, the American Home Economic Association, Consumers' Research, Consumers' Union, and the Better Business Bureaus. Various government agencies, particularly the Food and Drugs Administration and the Federal Trade Commission, have also been active in this respect; but much more should be done, not only in stopping misrepresentation in advertising but in providing reliable information for consumers. The federal

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[5] Temporary National Economic Committee, *Monograph No. 1*, p. 62.

Bureau of Standards spends millions in testing various products, but its findings are practically available only to big business concerns, and to government purchasing agencies which use the information in buying supplies for the government. Unfortunately it is not politically feasible to broadcast such information to the public; it might interfere with "business."

A simple example of the savings made possible by government testing and the publication of reliable information is afforded by the milk supply of many cities. At one time consumers knew little or nothing regarding the quality of the milk offered for sale by various dairymen, and as a result much that was sold was poor in butter fat, dirty, and even dangerous to health. Milk from cows in the last stages of tuberculosis was occasionally sold to families with babies and children. Then some cities set up health departments which tested the milk from various dairies, and in some cases published their findings. As a result, not only were consumers enabled to buy pure and wholesome milk, but dairymen were relieved of the expense of advertising, for if they produced good milk there was no reason to advertise, and if their milk was reported as poor, dirty, or unsafe, it was useless to advertise. The final result was to raise practically all milk to a high standard and to increase its consumption. The public and the dairymen both gained, but there was less advertising.

Any program which would raise the level of consumer information and rationality would raise the general standard of living, and therefore, in the long run, the incomes of retailers, wholesalers, jobbers, and manufacturers. This will seem heretical to most businessmen, but it is unquestionably true. If real incomes were generally increased, the incomes of retailers and other businessmen could not fail to share in the increase. If consumers were well informed and highly rational, retailers would have to eliminate poor, shoddy, and overpriced goods from their stocks and would have to carry only the best qualities, prices considered; but they could sell more, because the consumers, now getting more for their money, would be able to buy more and would feel *inclined* to buy more, because they would have greater confidence. Fleecing customers through the sale of inferior or overpriced goods certainly does not help the retailing business, for inevitably some of the customers will find out that they have been cheated. Manufacturers would gain too, from any increase in consumer information and rationality, for they could not fail to benefit from the general rise in incomes. Those who produce inferior or overpriced goods would of course have to improve their products or reduce their prices to the level of the quality; but they should be able to make as high incomes producing good things as tawdry things, producing for informed and rational people as for uninformed and irrational people.

Not too much should be expected in consumer protection, however, because powerful interests are opposed to any serious interference with advertising, or to any policy that will raise the level of consumer intelligence very much. Even when the economizing of human energy is imperatively needed, as it was in World War II, the canners' association, with the help of advertisers and the newspapers, was able to defeat every proposal for the effective grading and marking of canned goods so that consumers could know what they were buying. The Congressmen who voted against the measures were wise, if not public-spirited, for by doing so they gained the support of the newspaper and advertising interests. Very few consumers knew what was going on. Businessmen who advertise extensively, and indeed businessmen generally, are opposed to any policy which goes further than merely curtailing some of the most flagrant forms of misrepresentation. Consumer ignorance is a vested interest, and those in whom it is vested have always fought hard against any serious interference with it.

Graphs of monopolistic competition

Although theoretical reasoning leads to the conclusion that most monopolistic competitors do not earn monopoly profits, some of them do. The price situation of such a producer is illustrated in Fig. 34. The producer produces *Oa* units, because the marginal cost curve crosses the marginal revenue curve at *a'*; and he makes a profit of *ecdf*, because the average total unit cost curve lies below the demand or average revenue curve for the amount *Oa*. In pure competition the output would have been

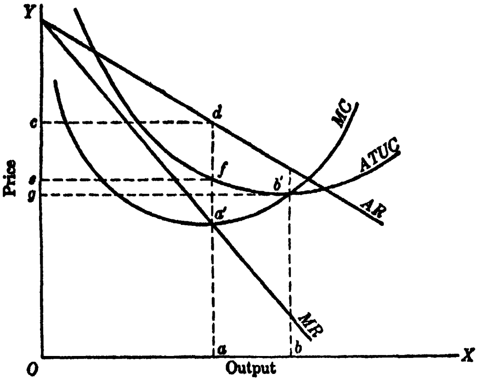

FIG. 34. Monopolistic Competitor Earning a Profit.

Ob, for in pure competition the output is extended to the lowest point on the average total unit cost curve, and this is the point where the marginal cost curve crosses it. In pure competition the output would have been greater by the amount *ab*, and the price would have been lower by the amount *cg*.

Generally, however, there are no monopoly profits in monopolistic competition. Fig. 35 represents this situation. Here the producer restricts production below what it would be in pure competition by the amount *ab*. A purely competitive producer would produce to *b′*, the lowest point on the average total unit cost curve. From Fig. 35, however, it appears that the monopolistic competitor can meet expenses only by producing *Oa* units; for any smaller or larger amount his costs would rise above his average revenues and he would suffer a loss. The student must avoid the notion that the monopolistic competitor, in the wickedness of his heart, is merely trying to exploit the public. Like the producer in pure competition, he tries to secure maximum net revenues, but he faces a different average revenue curve, one which impels him to restrict production.

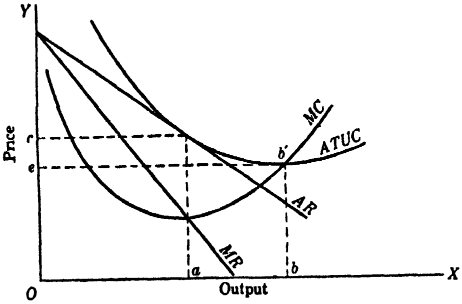

FIG. 35. Monopolistic Competitor Earning No Profit.

Price regulation

We have considered the problem of price regulation for a purely competitive industry and for a monopoly. It will be remembered that in pure competition a price fixed below the equilibrium price reduces the amount supplied below the amount demanded and makes it necessary for the government to encourage production in some way or to reduce the amount demanded, by rationing, for instance. Government price reduction for a monopolist, as we have seen, *may* result in an actual increase in output. What of government price regulation in monopolistic competition, such as we had during the war?

If a monopolistic competitor is making a monopoly profit, the case is clear. His situation is fundamentally the same as that of a true monopolist, and government reduction of his price, if not too severe, may result in increased output. But suppose the monopolistic competitor is making only average total unit costs, including wages of management. Clearly he presents a different problem, as we can see from Fig. 36.

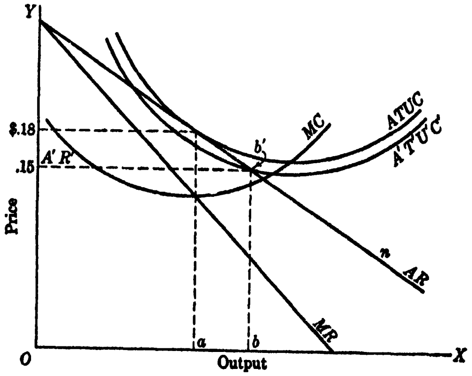

FIG. 36.

Here we assume that the producer has fixed his price at 18 cents, at which price he is producing *Oa* units and making no profit but is covering his costs, and that the government has ordered him to restore an earlier price of 15 cents. As in the case of the monopolist in Fig. 33, the government price gives him a new average revenue curve, a line horizontal from A′R′ to b′, and sloping from b′ to n. It is clear that there is no output at which he can realize enough to cover his average total unit costs, for the *ATUC* curve lies above the *A′R′* curve at all points. He is apparently in a serious situation.

There is, however, a possibility of reducing costs. Let us assume, first, that by cutting out most of his advertising expense he can get his average total unit costs down to the new curve *A′T′U′C′*. His total cost curve will now be tangent to the new average revenue curve at *b′* and he will be covering costs again; and, as in the case of the monopolist, he will actually have increased his output as a result of the lower price imposed upon him by the government. But how can he increase sales when he reduces his advertising? He will increase sales because he has reduced his price; and the cut in advertising may have little or no effect if other producers in the industry also cut down their advertising, for competitive advertising is largely wasted effort, mutually self-defeating. The prices of other producers in the industry are also being reduced, and presumably many of them are in somewhat the same position as the one shown here.

This may seem a grotesque misrepresentation of the actual effects of price control in an emergency such as war. For example, during World War II there was far more advertising than there was before the war, but it was done largely by concerns that were making excessive war profits and were spending on advertising the money which would otherwise have been taken by the government in taxes. What such a situation amounts to is that the government pays most of the advertising expenses.

Actually, the monopolistic competitor is likely to cut costs not by reducing his advertising but by reducing the quality of the product or the size of the package or the character of the service; but since this constitutes practically an evasion of government price fixing it will not be considered here.

QUESTIONS

1. Define monopolistic competition, and distinguish the three forms in which it appears. Give actual illustrations of each.
2. "True duopoly and oligopoly are rare." Why?
3. In what various ways may products be differentiated?
4. Distinguish between monopoly and monopolistic competition. Since the Aluminum Company of America must meet the competition of other metals, is it not a monopolistic competitor? Since the producer of Ivory Soap has a monopoly of his brand, why is he not a monopolist?
5. "A monopolist's power over his price depends on the extent to which there is freedom of entry into the industry." What various obstacles may there be to this? What is the important obstacle to entering the manufacture of drugs and cosmetics? Is there any obstacle to entering farming?
6. "Theoretical reasoning leads to the conclusion that generally there can be no monopoly profit in monopolistic competition." Explain.
7. A purely competitive producer, a monopolistically competitive producer, and a monopolist, expand production to the point where what equals what? Draw a graph for each.
8. What is it, fundamentally, that fixes the limit beyond which it is unprofitable for a monopolistic competitor to advertise?
9. What effect would full information and rationality on the part of consumers have on the costs of production of monopolistic competitors, on the quality of goods, on the price, and on the standard of living?
10. "The evils resulting from monopoly are restriction of production, high prices, and large profits, which the monopolists do not invest in new plant because they do not want too much production. The evils of monopolistic competition are restriction of production, high prices, and high costs." Explain clearly.

11. "National advertising has to some extent changed the nature of the retailing business." How?
12. Do you think you would obtain better service from doctors, lawyers, and dentists if they were accustomed to advertise? Would you be able to choose a doctor, lawyer, or dentist more intelligently?
13. If producers in a given area were to get together and by common agreement cut their advertising expenditures 50 per cent, how would it affect the sales of each?
14. "The prevalence of advertising indicates a tendency toward pure competition." Do you agree? Explain. "Absence of advertising might indicate either pure competition or pure monopoly." Why?
15. "The total expenditure for advertising probably amounts to less than 3 per cent of the aggregate sum paid by 'terminal buyers' [consumers] for finished goods." Is this cost of advertising the only cost chargeable to consumer lack of information and irrationality? Explain.
16. Consumers' Union found that some brands of sunglasses selling for 50 cents were excellent, whereas others that sold for $5.00 were seriously defective. Would it benefit producers of *other* kinds of goods if consumer rationality in the purchase of sunglasses could be raised?
17. Argue that any rise in consumer rationality will raise the incomes of merchants and producers as well as the real incomes of consumers, in the long run. How would it affect the incomes of newspapers?

Part IV

EXCHANGE

Chapter 19.

Money

There is thy gold, worse poison to men's souls,
Doing more murders in this loathsome world,
Than these poor compounds that thou mayst not sell,
I sell thee poison; thou has sold me none.
—*Romeo and Juliet*

Sound money an important productive agency

The exchange of goods in a modern economy would be impossible without the use of money. In facilitating the exchange of goods, money is as truly a productive agent as the farmer's plow or the spinning machines in a textile factory. History records scores of illustrations of the fact that an unstable or unsound monetary system can bring more distress than almost any other economic malady except war; and it often comes as a result of war. Conditions during the Revolutionary War, as described by Peletiah Webster, are a good example: "We have suffered more from this [paper money depreciation] than from every other cause of calamity. . . . It has also polluted the equity of our laws, turned them into enemies of oppression and wrong, corrupted the justice of our public administration, destroyed the fortunes of thousands who had most confidence in it, enervated the trade, husbandry, and manufactures of our country, and went far to destroy the morality of our people."[1]

History of money

The average person today takes our fairly sound and convenient money for granted, much as he does electric lights and refrigeration; but good monetary systems have been of comparatively recent origin. For half a million years, more or less, the human race did its trading, if any, by barter; for the next two thousand years the more advanced people managed with generally unsatisfactory coins of various kinds; and for a bare century or two most of the enlightened nations have had fairly stable and satisfactory monetary systems most of the time.

Barter, however, is an extremely clumsy and inconvenient way of making exchanges, for it calls for "double coincidence" of desires—that is, *A* must want what *B* has to trade, and *B* must want what *A* has; furthermore, each must want the amount that the other has, or further barter will be required to dispose of surplus stocks. Jevons' story of the French singer on a tour of the world illustrates these difficulties particularly well. For singing in the Society Islands she received as honorarium "three pigs, twenty-three turkeys, forty-four chickens, five thousand coco-nuts, besides considerable quantities of bananas, lemons, and oranges." Finding it difficult to use these assets to any advantage, she was finally driven to feeding the fruit to the pigs and poultry.

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[1] Ray B. Westerfield, *Money, Credit, and Banking*, p. 146.

Barter has been resorted to more or less even in advanced countries in comparatively recent years. Much of the trade in pioneer communities was a form of barter, the farmer "trading" his eggs and butter for goods at the general merchandise store—to such an extent, indeed, that he often spoke of going to town to do his "trading" rather than his "buying." Even today there is some of this type of bartering, and in times of deep depression it tends to increase.

Historically, a great many things have served some or all of the functions of money; in fact, almost all movable goods have been used at one time or another. In the hunting stage of human history, furs and skins served widely as money; in the pastoral stage, cattle; in the agricultural stage, various staple crops and other things—salt, ivory tusks, shells, feathers, arrowheads, bullets, fishhooks, knives, beads and wampum, animal skulls, nails, cotton cloth, straw mats, gold dust and nuggets, iron and copper utensils, engraved stones of various kinds, and even immovable property, as for instance the carved rocks on the island of Yap.[2]

The coinage of money originated perhaps a thousand years B.C., with iron, copper, and brass used at first, and later silver and gold. In the very early history of coinage, such metals as iron, copper, and brass were scarce and hence valuable enough to serve as money; but when they became more plentiful they gave way to the precious metals, gold and silver, used with alloys of cheaper metals. The early coins were handmade, often irregular in shape and size and in purity of metallic content. For this reason many of them did not circulate freely but were taken "by weight," or perhaps had to be appraised in some other way; the money-changers whom Jesus drove out of the temple were experts in appraising coins. The early coins were also too scarce to serve business needs adequately. Throughout most of ancient and medieval history, business was gravely handicapped by the lack of uniform, sound, and adequate money. It was not until the sixteenth century—about the time that the flow of gold and silver from the New World provided the material for a more plentiful and generally satisfactory money—that efficient mechanical methods of coining were developed. Money troubles were not over, to be sure, for some of the most serious economic disturbances in the history of the United States have been partly due to monetary causes, particularly to changes in the purchasing power of money.

Money defined

There are various definitions of money and various conceptions of money; but we may define it as *anything that is generally acceptable as a medium of exchange.* Such a definition would include all the different kinds of money in common use in the United States—silver coins, silver certificates, Federal Reserve notes, United States notes, and the like. Money is often held to include demand deposits in banks because the vast bulk of payments are made through checks on deposits, although checks are of course not generally acceptable as a medium of exchange.

Functions of money

Money serves several functions. In the first place, it serves as a *medium of exchange,* a device that enables us to exchange goods for the desired amount, quality, style, and size of other goods and thus to avoid the difficulties of barter. In the second place, money serves as a *standard of value* by which we can reckon the values of various goods and services. Somewhat as the inch, foot, or yard serves to measure relative physical magnitudes, so the dollar, pound, mark, franc, or ruble serves to measure relative values. It would be easy to underestimate the significance of this function, the extent to which it economizes human energy by enabling people to buy and sell with the minimum waste of time and the minimum chance of being cheated. The average man, in the course of years of buying and selling, comes to have some ideas as to reasonable money prices for several hundred commodities and services. Many prices change from time to time, to be sure, and he cannot keep well "posted" in periods of rapid price changes, but he is able to keep up to some extent even with changing prices. With such knowledge he can do his buying and selling quickly and with reasonable assurance of receiving fair treatment. Now suppose that, instead of let us say 300 prices quoted in money, he had to learn the ratios in which each of 300 commodities would exchange for each of the other 299. He would have the infinitely harder task of remembering 44,850 ratios, and he would do it only indifferently.

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[2] See M. Palyi's article in *Encyclopaedia of the Social Sciences,* vol. iii, p. 622.

In the third place, money serves as a *standard of deferred payments* by which present and future values can be correlated. Not all goods are paid for immediately; and in every credit transaction there is an assumption that the money of a future time will be of approximately the same value, the same purchasing power, as the money of the present. This function is extremely important today, with the total of all kinds of debts in the United States climbing to a record figure of nearly 300 billion dollars. It must be conceded that our money has not served very satisfactorily as a standard of deferred payments, particularly since the First World War; for example, the value of money nearly doubled between 1929 and 1932, with the result that debts incurred in 1929 and paid in 1932 were paid with money that would buy almost twice as much as the money lent.

Finally, money serves as a *store of value,* a means by which one may "store" a given amount of wealth for later use. In the process of saving, an individual usually accumulates money at first, and he may wish to hold it as savings for some time. Among some primitive peoples, in European countries during the Middle Ages, and to some extent in France until very recent years, it was not uncommon for people to hoard money or precious metals or jewels. The French people paid the war indemnity at the close of the Franco-Prussian War partly with hoarded gold. Hoarded money is not circulating, is not really serving the most important functions of money; but all money must be held out of circulation at times, and it serves an important function as a store of value. It would be inconvenient and expensive to store bulkier commodities, even those that were not perishable; and it is somewhat expensive to store money, because the holder receives no interest on it when it is stored or hoarded.

Classification of money

Money may be classified in various ways, but the following classification will be used here:

I. Metal money
  Gold
  Silver
  Minor coins
II. Paper money
  Representative money
  Government notes
  Bank notes
III. Bank deposits, demand only

Metal money

Gold. For centuries it has been the custom to make money from gold or silver, and for three-quarters of a century almost every country has used gold for "standard money." Gold has many qualities that make it probably the most satisfactory metal for coinage. It is beautiful, easily malleable, extraordinarily durable; it does not rust or corrode, and its value has probably been as stable as that of any other metal. Silver is equally good in some respects, but it oxidizes and it is too cheap to serve for coins of high denomination. A silver coin worth ten dollars would be awkward to carry around, just as a gold dime, quarter, or even a dollar would be too small for convenience; hence gold has been used for coins of large denominations, and the cheaper silver for "change." Because both gold and silver, particularly gold, are so soft that they wear considerably in use, they are mixed with alloys to make them harder. Metal coins are used far less than they once were, except in the form of subsidiary and minor coins—half dollars, quarters, dimes, nickels, and pennies. Before World War II our nickels were made of copper, 75 per cent, and nickel, 25 per cent, and the pennies were mostly copper; but the war need for copper and nickel led to some substitution of other metals. Silver nickels and pennies would be too small for convenient use. Silver dollars still circulate to some extent, but gold has been withdrawn from circulation.

Before 1933, although the gold dollar was not coined, it was "standard money" in the United States, the money to which other moneys were referred; that is, the value of other silver and paper moneys, none of which were worth their face value as commodities, was defined, partly in the case of silver and wholly in the case of paper, by the fact that they could be exchanged for gold coins. It was on the foundation of gold that our superstructure of silver and paper money rested. This is to a certain extent true even now, for the vast store of gold belonging to the government is presumably being held as the basis of our monetary system, even though the government will not exchange it for other moneys as it formerly did.

The early metal coins were sometimes "clipped" and "sweated" so that they were no longer of their original sizes. "Clipping" is the practice of cutting or shaving a little from coins, and "sweating" is the practice of placing coins in a bag and shaking them to get the metal dust that collects in the bag. To make such practices more difficult, coins are milled at the edges and stamped on both sides. In modern times, the need for uniform and reliable coins has forced the government of practically every important nation to assume the prerogative of coinage; and counterfeiting or defacing coins is severely penalized.

Prior to 1933, gold money in the United States was what is often called "full-bodied" money; that is, its value as a commodity was equal to its value as money. Anyone who had gold could bring it to the mint and sell it at the rate of 23.22 grains of fine gold for a dollar, and anyone who had a five-dollar gold coin could melt it and get five dollars' worth of gold —116.1 grains (23.22 × 5). This equality of commodity value and money value was due to the policy of "free, gratuitous, and unrestricted coinage." Coinage is free if the government stands ready to coin all the metal offered. As long as our government stood ready to buy gold at the rate of one dollar for 23.22 grains of fine gold, with no charge for coinage, there could be no deviation from this ratio. Gold coins have not been in circulation since 1933, but the government still buys gold without restriction, although it pays a dollar for only 13.714 grains of fine gold. To put this another way, the government now pays $35.00 per ounce for gold, whereas before 1933 it paid only $20.67. The gold purchased is kept as bullion.

Silver. Silver coins have not been coined freely since 1873, when the silver dollar was dropped from the list of coins to be struck. They have been coined under various acts of Congress, but there has been no provision for free coinage of unlimited amounts of silver, as there was for gold. The result is that neither silver dollars nor subsidiary coins—half dollars, quarters, and dimes—have been worth their face value as bullion; in fact, the subsidiary coins fall short more than the dollar, because since 1853 their fractional relation to the dollar has been reduced 7 per cent. That is, two fifty-cent pieces contain 7 per cent less silver than the dollar; and quarters and dimes are similarly debased. This reduction or debasement became necessary when, following the discovery of gold in California and Australia, silver money of all kinds was being crowded out of circulation by the relatively plentiful and "cheap" gold, with the result that there was an inconvenient shortage of silver change for small purchases. Subsidiary coins, and nickels and pennies, are struck by the government only in such amounts as business calls for. Since the metals cost less than the face value of the coins, the government makes a profit in coining them.

When the government, in buying metal for coinage, charges the seller for the alloy metals used in coinage and for the coinage itself, it is said to be charging *brassage;* if it charges more than this, the charge it called *seigniorage.* The policy of the United States government has generally been free and gratuitous coinage, that is, not even brassage is charged; but in France seigniorage has often been collected. Such charges are important in relation to bimetallism, as we shall see later.

Money in Circulation, as of December 31, 1945
(In millions of dollars)

Gold certificates	$ 51
Federal Reserve notes	24,388
Treasury currency	4,075
Standard silver dollars	136
Silver bullion	——
Silver certificates and Treasury notes of 1890	1,873
Subsidiary silver coins	832
Minor coins	307
United States notes	316
Federal Reserve bank notes	494
National bank notes	117

Paper money

Representative money. Paper money, now far more common than it used to be, is classified as follows: representative money, government notes, and bank notes. Before 1933 we had two forms of representative money—gold certificates and silver certificates. These paper moneys certified that gold or silver coins of stated denomination were deposited in the Treasury and would be paid to the bearer on demand, the paper certificates being used instead of the gold and silver coins because they were more convenient to carry and because they saved wear on the coins. Silver certificates are still used, but gold certificates (yellowbacks) were retired from circulation in 1933, along with gold coins. (It will be remembered that the murderer of the Lindbergh baby was apprehended when he tried to circulate a gold certificate.) The use of representative paper money raises no serious monetary problems. In the case of gold certificates, there can be no danger of overissue, insufficient backing, or unsoundness in any respect; and there can be little danger in the case of silver certificates, although there is an element of credit in them, since there is much less than a dollar's worth of silver behind a dollar certificate. The government makes a small profit from the use of representative money because a small amount of the paper is lost or destroyed every year; thus the coins—or the uncoined bullion—are left in the Treasury with no claims against them.

Government notes. Government notes are promises of the government to pay a certain amount to the bearer, the promises being backed by a gold reserve. They have often been issued in time of war when taxes and loans were insufficient to pay war costs. During the Civil War a considerable amount of "greenbacks" were issued, of which only a few are still in circulation. They should never have been issued, for they were one of the causes of the rise in prices during the later years of that war—as is always true of government note issues to pay for a war.

Federal Reserve notes should perhaps also be classed as government notes since they are issued by the Federal Reserve banks, which may be considered government institutions, and since they are redeemable in lawful money—but not in gold—at the federal Treasury or at any Federal Reserve bank. These notes are backed by gold certificates to at least 25 per cent of their face value, and for the remainder of their face value by government bonds or by commercial paper—notes, discounts, and other such paper. In their provision for backing, these notes are unlike the greenbacks, which were at first merely government promises to pay, and later (1879) were backed by a gold reserve of a little over 150 million dollars. From the above table it may be noted that the Federal Reserve notes constitute much more than half of the money circulating in this country.

Federal Reserve bank notes are like the Federal Reserve notes in being issued by the Federal Reserve banks and in being redeemable in lawful money at the Treasury; but they are backed by government bonds, like national bank notes, or by approved commercial paper up to 90 per cent of their face value. The few hundred million still outstanding are being taken out of circulation.

Convertibility of paper money. Paper money may or may not be convertible into gold or silver. Between 1879, when greenbacks were declared convertible, and 1933, when gold was withdrawn from general circulation, all the paper moneys in the United States were convertible into gold, directly or indirectly. There was not enough gold to redeem all the paper money at once, but as long as people generally had confidence in the monetary system, not much paper money was presented for redemption. As a matter of fact, the gold reserve sank so low in the early 'nineties that there was some doubt whether the government would be able to continue redeeming greenbacks, and large amounts of them were presented for redemption; but the government was able to maintain convertibility.

Bank notes. Bank notes, at one time an important element in our monetary system, represent something different from government notes. During much of the period before the Civil War, state and private banks, subject to little or no regulation, issued vast amounts of "wildcat" currency, much of it with scant backing of any sort, some of it worthless when the first business depression struck.

There were so many issues of different values that businessmen often carried little books containing late quotations on the value of the notes of different banks. When the National Banking System was established in 1863, a prohibitive tax was put on the issue of notes by state banks, and the national banks were authorized to issue notes. These national bank notes are fully backed by United States bonds, the government guarantees the payment of the notes in lawful money, and there is a redemption fund of 5 per cent of the face value of the notes in the Treasury at Washington—a fund formerly in gold, but now in "lawful money" —for current redemption of such notes as may be presented for payment. Although there is no question as to the soundness of our national bank notes, the government has retired all but 123 million of them, and the present plan is to retire them all. Their place is being taken largely by Federal Reserve notes.

That notes issued by privately owned banks should be used as money seems rather strange. When bank notes are backed by government bonds as national bank notes are, they are of course sound; in fact, our national bank notes were originally a device to provide a market for government bonds. The privately issued bank notes represented merely the debts of the banks. The use of such *debts* as money is doubtless explained by the fact that the frontier states were not yet wealthy enough to afford good sound gold or silver money, and by the fact that the frontiersmen were generally ignorant of monetary principles. At any rate, in the issue of paper money as in so many economic activities, we see a shift from private enterprise to government intervention and finally to government activity. In less than a century, the issuance of notes shifted from privately owned and managed state and private banks to closely regulated banks, and finally to virtual government agencies, the Federal Reserve banks.

Bank deposits

Bank deposits do not fit all the requirements of money, because the checks drawn on deposits do not circulate freely; but they are often classified as money because they are the means of making most payments—more than 90 per cent of the total dollar volume. They will be discussed more fully in the next chapter; but for the present we may state that in times of normal business activity most deposits represent credit, *loans* to the depositors. When a man borrows $1000 from his bank, the bank ordinarily creates a deposit of $1000 in his favor, in return for which the borrower makes out a note to the bank. The immediate effect of the transaction is to create two debts —the debt represented by the deposit, which is now payable to the borrower, and the debt represented by the note, payable to the bank. The deposit, through the use of checks, becomes money which may be used in making payments. The deposit is similar to a bank note, which is also a debt of the bank. As in the case of a bank note, "deposit" money is created by a privately owned bank; that is, the money represents the debt of the bank. The supply of deposit money is regulated not by the government (except within broad limits, as we shall presently see), but by the bankers, by their willingness and opportunities to make loans. If a private individual "makes" a silver certificate or a silver dollar, he is counterfeiting and is sent to the penitentiary; but banks create money—deposit money—all the time, and destroy it at will by calling in loans and restricting deposits. The significance of this will be apparent later. During World War II, it may be noted, the banks lent more to the government than to individual businessmen, and most of the bank deposits represented these war loans.

Inconvertible paper money and inflation

Inconvertible or fiat money is money which cannot be converted into gold or, in the case of countries on a silver standard, into silver. The paper money of the United States is now fiat, although until very recently the government had more than enough gold to redeem it at any time. In such a situation, inconvertible paper money offers little danger. When, however, a government with an inadequate reserve of gold or silver, particularly one that is already in a weak financial position, issues inconvertible paper money, there is always danger that it may issue so much as to bring on a disastrous inflation of prices. This has often happened in wartime. A government at war, unwilling or unable to raise enough by taxation to pay the heavy expenses of war, has often resorted to printing paper money for this purpose. This is hard to halt, for as more money is printed, prices rise, and as prices rise, war supplies cost more and more money must be printed, until the upward spiral is stopped either by the termination of the war or by the money's decline to complete worthlessness. The colonies often resorted to the printing press to pay government expenses, as did also the Continental Congress and the colonies in the Revolutionary War. "Not worth a Continental' is a phrase suggestive of the final value of this paper—less than one cent on the dollar. During the War of 1812 the process was repeated on a less extravagant scale, and again during the Civil War the federal government issued paper which declined to less than half its face value in gold, the Confederate paper was never redeemed. One of the advantages of convertibility is that if the government is required to back the paper with metal, it is not likely to issue excessive amounts.

Inconvertible paper money issued by a government in a sound fiscal position and properly restricted in amount, may be a perfectly acceptable form of money if the people have confidence in it. For the present, our inconvertible paper is sound and satisfactory; but if the government should prove unable to balance its budget for many years and the federal debt rose to a point where its final payment was highly doubtful, the government might conceivably resort to paper inflation, as Germany did in 1923. No government embarks upon such a policy in ignorance of the tragic consequences of a runaway inflation; history records many such disastrous episodes, and few public officials are unaware of the grave dangers involved. But a government which is unable to meet its expenses by taxation sometimes resorts to this policy, usually not until it has first tried to raise money by borrowing—issuing bonds. If its financial position is notoriously unsound, however, the bonds may be hard to sell, and paper money thus becomes the last desperate recourse.

Debasement of metal currencies

Inflation has often come by other means than the issue of paper money. In medieval times it was frequently the result of *debasement of the currency*—an increase in the percentage of alloy used in metal coins. By increasing this percentage, the king could make *more* coins and use part of them, in lieu of taxes, to pay government expenses. Like the issue of paper money, this debasement was likely to become progressive and was very difficult to stop; the result was rising prices and ultimate worthlessness of the coins. In France, particularly during the reign of Philip the Fair, there was much complaint of the people's stubbornness in refusing to accept the debased coins; on the other hand, one of the greatest achievements of Queen Elizabeth was the establishment and maintenance of sound money. Henry VIII, burdened with the expenses of his many marital ventures, had never been able to do this and had resorted to debasement on various occasions. Far different in purpose from the debasement of medieval times was the debasement of the United States gold dollar in 1933, by reducing its gold content from 25.8 grains of nine-tenths fine gold to $15\frac{5}{21}$ grains. Here the purpose was to raise prices, but the effect was the same as if the gold dollar had remained at 25.8 grains gross weight, and the difference between the gross weight and $15\frac{5}{21}$ grains had been made up of baser metals.

The gold standard

A country is said to be on the gold standard when the standard money into which all other moneys may be freely converted is gold, and gold is "legal tender" for payment of all obligations—that is, it must be accepted in payment of obligations—when it is bought and sold in any amount in a "free market" by the government, and is coined freely. England was on the gold standard actually from 1696 to 1931, and officially from 1816 to 1931; in reality the United States was on the gold standard from 1879 to 1933, although the gold standard was not officially adopted until 1900.

The gold standard proved fairly satisfactory for more than half a century. Gold is about as stable in value as any metal. Its production varies considerably, and its value varies somewhat with production but by no means in proportion to production. When the gold mines of the Americas were first exploited in the sixteenth century the vast increase in production raised prices in Europe 200 to 300 per cent; similarly, the Californian and Australian gold discoveries (1848 and 1851) increased the production of this metal several hundred per cent within a few years, with a consequent considerable rise in the price level. The United States was officially on a bimetallic and not on the gold standard at the time, but gold was practically the only metal in circulation. Again in the period beginning about 1891, the discovery of gold in the Klondike and in South Africa brought production up greatly, with resulting rising prices, recognized by the people as the "high cost of living." In periods of declining gold production or even stationary production, on the other hand, prices have often declined. This was the situation from 1873 to 1896. The production of silver has varied quite as much as that of gold, and most of the people of the world have long had a general preference for gold.

Not only has gold preserved fair stability in value. As long as it was used as a standard money by nearly all countries (from the 'seventies until the First World War), it served admirably for international payments of all kinds, for adjustments of international trade, and for the equalization of the price levels of the different countries. The gold standard was automatic in operation, called for little government intervention, and provided a solid basis for business confidence. It is not certain that a better standard will ever be found.

Bimetallism

During most of the nineteenth century many nations were experimenting with bimetallism, the use of both gold and silver. A bimetallic system involves two essential conditions: (1) the free and unlimited coinage of both gold and silver at a fixed ratio of the weights of the two coins, and (2) full legal tender of both coins at this ratio. Under a bimetallic system with the ratio fixed at say 30 to 1, the government would pay thirty times as much for gold as for silver, would buy either metal at this ratio, and would coin both of them for circulation.

Bimetallism has usually been advocated in periods of declining prices as a means of keeping prices up by increasing the supply of money; but we are no longer on a metal monetary standard and bimetallism is therefore of only historic importance. The history of bimetallism affords many illustrations of the great monetary principle known as *Gresham's law*, which is often incorrectly stated: *Cheap money drives out dear money.* In the operation of bimetallism, however, this law should be expressed more specifically, as follows: *The metal which is overvalued at the mint tends to drive out of circulation the metal which is undervalued at the mint.*

Monetary history of the United States

Alexander Hamilton, the first Secretary of the Treasury, set up a bimetallic standard for the United States in 1792, with a ratio of 15 to 1. This was very near the market ratio at the time, but the market ratio soon veered higher, to about 15½ to 1, with the result that gold, valued more highly in the market than in the mint, flowed largely to European gold markets rather than to the mint. This tendency was further emphasized when Napoleon established bimetallism in France in 1803, with a nominal ratio of 15½ to 1 (actually, because of the seigniorage charged, about 15.67 to 1). The United States government was having great difficulty in keeping even the silver dollars in circulation, for in accordance with Gresham's law, silver dollars, and fractional silver coins as well, were being taken to the West Indies, where they were accepted by the people as readily as their own heavier silver coins; but even if the financial position of the new country had been otherwise sound, it would have been impossible to attract much gold to the United States mint when the French mint valued it more highly. Jefferson stopped the coinage of silver dollars in 1806, but this did not provide an adequate monetary system.

Finally, in 1834 and 1837, Congress in its wisdom changed the ratio to 16 to 1, which was *higher* than either the market ratio or the mint ratio in France and India. In France the nominal ratio was still 15½ to 1 (the actual ratio was about 15.67 to 1). This overvaluation of gold, or undervaluation of silver, brought gold to the mint, but, in accordance with Gresham's law, silver flowed mostly into the market and to foreign mints. Again bimetallism was not working well, for our currency now was almost all gold. Gold tended even more strongly to drive silver out when the gold discovery in California in 1848 brought the market value of gold even lower, and so made it even more overvalued at the mint. Lack of silver dollars would perhaps not have been an intolerable hardship, but lack of subsidiary silver coins was a great inconvenience to the people, and in 1853 Congress debased these coins about 7 per cent to keep them in circulation.

Eight years after this the Civil War began, and both the northern and the southern governments issued so much paper that gold and silver were driven out of circulation, most of our supplies going to Europe; but our official monetary system was still bimetallic. In 1873, while greenbacks still served as our common money, the standard silver dollar was omitted from the list of coins to be struck, thus practically putting the country on a nominal gold standard—nominal because actually we were on a paper standard until 1879, when conversion of paper into gold was resumed. The Act of 1873, later called the "Crime of 1873" by silver producers, did authorize the coinage of an extra-size silver dollar known as a "trade dollar," but it was dropped three years later.

The period of about thirty years following the Civil War was one of generally falling prices, of distress for debtor classes, particularly farmers in the Middle West who had mortgages on their farms, and of continuous efforts on the part of the debtor classes and western silver miners to return to bimetallism in order that there might be more money, steadier prices, and a market for silver. Farmers who had mortgaged their farms in the early 'seventies found that as the price level tumbled they had to pay their interest and perhaps their debts in money of greater purchasing power, and many lost their farms. Unfortunately for the silver miners, silver was dropped about the time that production began a dramatic recovery, and the price of the metal soon began to fall.

Other events conspired to cheapen silver. In the first place, many European countries—Germany was the first—dropped silver during the 'seventies and adopted the gold standard. Thus, important markets—the mints of some European nations and of the United States—were closed to the white metal. In the second place, the production of gold, which had risen rapidly between 1850 and 1870, declined in the 'seventies and did not regain the earlier level until 1890. Production was not adequate to keep the price level up, and as a result the prices of all commodities, including silver, which was now only a commodity, declined.

Thus the country practically adopted the gold standard about the time that gold production began to decline and prices started their long slide to the low levels of 1896. The monetary history from 1873 to 1900 is the story of the compromises between the debtors and miners, with their campaign for bimetallism, and the sound money advocates. In 1878 the Bland-Allison Act, the first compromise legislation, provided not for free and unlimited coinage of silver, but for the coinage of from two to four million silver dollars per month, the coins to be full legal tender. The price of silver continued to decline, however, and the general price level continued its zigzag course downward. Whether the new silver dollars increased the total amount of money in circulation or not is not certain. So great was the general suspicion regarding their soundness that it was difficult to put them into circulation; and once in circulation, they tended to displace gold in accordance with Gresham's law. The country was drifting toward a silver standard. Yet in 1890, after two international conferences had failed to secure any international agreement on bimetallism, another compromise act, the Sherman Act, was passed. This provided for the purchase of 4.5 million ounces of silver monthly, to be paid for in legal tender treasury notes. In the three years that this act was in force, enough silver was bought to coin 218 million dollars.

Gold production was still low; prices were declining; debtors were rebellious; a new inflation party, the Populist party, arose in the agricultural states of the Middle West; and the silver producers were dissatisfied. The economic condition of the country was bad, and leaders in both parties in Congress really leaned toward bimetallism. It seemed that gold production was inadequate to maintain a steady price level, and that prosperous business conditions could not be maintained if this level declined persistently. Yet the new silver dollars were driving gold out of circulation, the Treasury's gold reserve was falling as millions were exported to Europe; and many people, particularly the powerful creditor interests in the eastern cities, were gravely apprehensive of the strong drift toward a silver standard. The year 1891 was one of great prosperity, with abundant crops here and, happily for us, poor harvests in Europe, and this postponed the coming crash; but in 1892 and 1893, economic conditions turned desperately bad, and gold again started to flow out of the country in such quantities that in 1893, soon after President Cleveland took office, the Treasury's gold reserve fell below $100,000,000. This brought widespread fear that some of our paper money would be redeemed in the steadily cheapening silver and that the country would shift to a silver standard. The United States was soon in a very serious financial and economic depression.

Most of the men in Congress doubtless believed that the price level ought to be raised and that this could not be accomplished as long as we were on the gold standard; but Cleveland, who belonged to the so-called "sound money" wing of the Democratic party, promptly called Congress together and insisted on the repeal of the Sherman Act. The cessation of silver purchases which followed repeal did stop gold exports for a short time, but they were resumed a year later, prices continued to decline, and business remained stagnant.

This was the general situation in 1896 when William Jennings Bryan, the peerless orator of Nebraska, ran for the Presidency on a platform calling for "free silver"—bimetallism—at a ratio of 16 to 1. In his own state and throughout the debtor farming sections of the West, Bryan saw farmers struggling with debts whose burden had been steadily increasing as the price level declined—as the *value* of money increased—and he insisted that the country must have more plentiful money and higher prices. He carried on a tireless campaign but lost the election to McKinley, who, although formerly an advocate of bimetallism, was running on a sound money platform. Bryan had the support of most western farmers, of silver producers, and of inflationists generally; but against him were arrayed the powerful banking and creditor interests, most of the tariff-protected interests, which feared the free-trade leanings of the Democratic party, and most of the important newspapers—a combination which until recent years has usually been invincible in American politics.

So the country was to hang on the "cross of gold" for at least four more years; but the cross did not prove so uncomfortable, for the forces which were to bring rising prices and prosperity were even then at work. Already in 1891 the production of gold had begun a spectacular increase which in the summer of 1896 started prices upward in a rise which was to continue until 1920; and in 1900 the gold standard was formally adopted. Debtors were contented, silver producers were doing a little better, and business was generally good. It appeared that Bryan had been wholly wrong. But he was not altogether wrong in his analysis of the situation which existed at the time he was campaigning and had existed for twenty-three years before that. The United States suffered greatly during those years of falling prices, and countries that used silver were able to maintain a steadier price level. Bryan did not foresee that the rising output of gold would bring the higher prices that he sought, and he was wrong in believing that it would have been possible to maintain bimetallism at a ratio of 16 to 1. The market ratio was nearly 34 to 1, and a mint ratio of 16 to 1 would have brought only silver to the mint.

The era of rising prices was satisfactory to most classes for some years, but finally the rise brought what was called a "high cost of living" and with it, various schemes to keep prices from rising so fast. The most publicized of these schemes, Irving Fisher's "compensated dollar," will be discussed in a later chapter. A precipitous price decline in 1920, following World War I, ushered in another long period of falling prices which again brought complaints from debtors, silver producers, and various other classes that suffered from the stagnation of business. Again, as in the 'seventies and 'eighties, there was widespread demand for inflation, "reflation"—anything that would start prices up and restore prosperity. This time the forces demanding monetary change were too strong to be denied; and in 1933 and 1934, the government, under the aggressive leadership of President Franklin D.

Roosevelt, adopted a rather complicated series of measures which resulted in the practical abandonment of the gold standard, the reduction of the gold dollar from 23.22 grains of fine gold to 13.714 grains, the withdrawal of gold from circulation and the prohibition of all private hoarding, and the purchase of both gold and silver at far above what had been world market prices.

Our present monetary system

The United States now does not have a gold standard, although more than 20 billions of the metal are stored in government vaults, it does not have bimetallism, although vast amounts of silver have been bought at home and abroad and stored away. It has what may be termed a paper standard heavily backed by gold and silver, often called a "managed currency." Or, viewing the vast hoard of gold and silver and the zeal with which the government is adding to it, we might perhaps say that we have a "hypothetical, psychological gold standard." To many economists the whole system seems crazy. What is the point of keeping a hoard of 20 billions' worth of gold? The interest on the amount invested, at only 2 per cent, represents an annual loss of 400 millions. What is the point of buying the world output of gold at a price far above what it is worth, when we already have too much? What is the point of buying silver and storing it away in vaults? Here the answer is that the western silver producers form such a powerful bloc that they cannot be denied. It is true that during the war we lost some gold to other countries, but it is not certain that this outflow will continue.

Yet the government, to use a common phrase, "has a bear by the tail." If it stopped the purchase of gold or reduced the price paid, the market price would fall drastically, and the value of our twenty-billion-dollar hoard would depreciate sharply—perhaps as much as seven or eight billion dollars. We could not sell the gold to the impoverished nations of Europe, for they could not afford to pay us for it in goods, and some of them are learning to get along without gold. It is highly doubtful whether most of the world will ever go back to the gold standard. There is one consolation—gold is beautiful and it keeps well. Perhaps the government will open the vaults some day and let the people see the sight; as a sight it should be worth something!

QUESTIONS

1. What are the functions of money? Why is coinage a prerogative of the government everywhere? Is this not a step toward socialism?
2. Why is gold better as a standard money than steel, platinum, copper, radium, wheat, or tobacco?
3. Between 1918 and 1920 many gold mines in the West were closed down; during 1933 to 1936, some of these were operating again. Why?
4. In the long run the value of gold, like that of any other commodity, is determined by demand and supply. For what two main purposes is gold demanded?
5. If the market value of the metal in the nickel, dime, quarter, and half dollar rose above their face value, what public inconvenience would result? When, in our history, did this situation arise?
6. In what periods of our history did the gold dollar serve badly as a standard of deferred payments?
7. Barter, though earlier in history than buying and selling, is in some ways more intricate. Explain.
8. Which of the following may be called money: a three-cent stamp, a silver certificate, a bank draft, a check, an ounce of gold, a gold certificate?
9. Trace the developments by which the issue of metallic money and paper money, which began as a private function, became a purely government function.
10. When the gold dollar was our standard money, what control did the government have over

the supply? How was the supply of gold dollars determined? What determines the supply of money, in its broad sense, today?

11. Why were people willing to accept the notes of banks (which represent mere *debts* of the banks) as money before the Civil War? Were the national bank notes any different in character after the Civil War?
12. What are the essential conditions of bimetallism? During what period of our history did we nominally have a bimetallic standard? When in our history were both metals actually in circulation? Why is our record no better?
13. When Bryan was campaigning for bimetallism at 16 to 1 in 1896, the factor that was to bring higher prices was already at work. What was that factor?
14. Name the different kinds of paper money. Would you hesitate to take any of them in payment of a debt? Since none of them is redeemable in gold, of what use is the gold hoard?
15. How can other nations return to the gold standard when we buy gold at a price that they cannot meet in the world gold markets?
16. What would you call our present monetary system: gold standard, bimetallic standard, fiat paper standard, "managed currency," or something else? Is gold an important element in it?
17. The government has some 20 billion dollars' worth of gold stored in vaults. What did it pay for this gold? At 2 per cent interest, what does it cost to hold it in storage? Would it be wise to buy 10 billion dollars' worth of goods from other countries with about half of it?

Chapter 20.

Credit, Banking, and Finance

Rags make paper, paper makes money; money makes banks; banks make loans; loans make poverty; poverty makes rags.
—Jacob Coxey, of Coxey's Army

Credit and debt

Credit may be defined as *the power to secure present money or goods or services on the promise of returning a future equivalent.* Usually it is extended in the form of money or a bank deposit, but it might take the form of goods or services. Even if the loan is in money immediately, it is usually goods or services that are really wanted. Credit is debt, looked at from a different angle; and as debt it has had a rather bad reputation for some centuries because of its habit of stealing the poor man's mortgaged homestead or, in an earlier period, of reducing the borrower to slavery. The use of credit runs back to early history, for it was apparently common at the time of Hammurabi about four thousand years ago. In ancient times, as in some primitive societies of recent times, the debtor who defaulted in his payment became a slave. In the later Middle Ages, slavery was superseded by imprisonment, which persisted well into the nineteenth century. In his *Pickwick Papers* and in *Little Dorrit,* Dickens pictures well the distress arising from imprisonment for debt. In modern times the debtor is not reduced to slavery or imprisonment, but he not infrequently loses much or all of his property. As Carver once said: "Credit is a useful instrument: so is a buzz saw."

Any credit transaction is based on confidence in the ability and willingness of the borrower to repay the loan, the confidence resting on his assumed integrity, on his ownership of sufficient wealth so that he can be forced to pay, on a mortgage, or perhaps on the "hypothecation" of *collateral*—bonds, stocks, or other valuable assets—with the lender to guarantee payment. As a result of the business uncertainty following the Great Depression, loans based only on integrity are relatively less common than they once were.

Wide prevalence of credit

Credit, or debt, is widely prevalent in the modern world, more so than most people realize. The federal government, most of the state and local governments, a great many farmers, home owners, and businessmen are heavily in debt; most of the railroads and public utilities and many of the great industrial corporations have large amounts of bonds outstanding, which represent debt owed to the bondholders. Goods are often sold on credit too, and there is an element of credit, or debt, in a vast number of common transactions: in life insurance, where the policyholder "owes" the insurance company the amount of the premiums if he is to keep the policy in force, while the company is in debt to him for at least the surrender value of the policy and for the face value when he dies; in accrued taxes not yet paid; in most salary contracts, when the employee is paid at the end of the month, and therefore earns a growing credit from the time of one payment to the next; in corporation disbursements, for the corporation may earn profits steadily from day to day but ordinarily pays dividends only every three or six months, in the meantime owing the stockholders the amount it has earned since the last payment, or if it "plows back" its earnings, it may owe the stockholders indefinitely.[1]

Classification of credit

Credit may be classified in different ways. A distinction may be drawn between producers' credit, used for productive operations, and consumers' credit, used for the purchase of consumers' goods. Most of the credit employed in modern times is used in productive business, and much of it is advanced by the banks. Banks have a general preference for producers' loans because such loans are likely to increase the borrowers' productive capacity and so provide the means of repayment. Loans to merchants to buy goods, to farmers to fatten cattle, to manufacturers to install machinery—such loans generally create new earning power out of which the loans may be repaid, although in ill-calculated ventures the results may be disappointing. Consumers' credit, on the other hand—loans to buy pleasure automobiles, radios, or fur coats—do not increase the borrowers' productive or earning capacity and so do not provide the means of repayment.

Producers' credit

Serious evils may arise from the use even of producers' credit. Many people are too optimistic when conditions are good, unable to realize how many kinds of disaster there are in the business world, how many ways of losing money. So generally is this true that one of the most important functions of a good banker is to prevent people from borrowing, or at any rate from borrowing too much. But many do borrow who should not, and many borrow too much; and the records of the personal tragedies that result would fill a rather large college library. Since debtors are generally persons of smaller means than creditors, overextension of credit probably tends to increase inequalities of wealth. But debtors are not always the ones who suffer in the lending business, for if the creditors are not secured in some way, they may find themselves trying vainly to collect debts which the debtors cheerfully ignore. The bankruptcy laws are sometimes used to defraud creditors.

On the whole, however, producers' credit probably adds to wealth in various ways. In the first place, it turns the control of productive capital over to those who want to use it and presumably can do so most advantageously. The use of credit does not directly and immediately increase the amount of productive capital. A loan from an individual saver to a borrower merely shifts purchasing power, shifts control over existing productive capital from the lender to the borrower, who, if his calculations are sound, is in a position to use it to greater advantage. If credit were never used, those who have money savings would themselves have to use them in some way, perhaps by buying tangible property which they would then have to manage, while those who would like to borrow to expand their operations would have to content themselves with the size of business that their own savings would finance. Some of them would doubtless be better off if they did this, but others go ahead faster because they can use credit. In the case of a bank loan, the borrower gains purchasing power, but the bank does not part with any purchasing power, because it merely *creates* the credit.

Producers' credit thus augments production by putting some productive capital in the hands of capable, energetic men earlier than they could secure such control otherwise. If credit were not available at all, industry would be almost altogether in the hands of well-established concerns which would be practically the only source of funds with which to establish new enterprises; and the spirit of business would very likely be unprogressive. A young man, however able and energetic, could not well save enough out of his salary to establish a considerable business until fairly late in life, perhaps after he has passed the peak of his energies. But through the use of credit, if he has some savings of his own and can convince the banker of his ability and integrity, he may be able to get a good start early in life and go ahead much faster than he could have otherwise. Some bankers are very shrewd in their judgment of businessmen's abilities, and it has been one of their functions to pick out the able men and hasten their rise to importance by advances of credit; but this function is less important now than it once was, for in recent years bankers have been less inclined to extend credit on personal qualities. Credit used in this way thus permits able young men to assume sooner the position in business for which their abilities fit them, and therefore it makes the business world more dynamic and probably it also makes industry more productive.

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[1] On the prevalence of debt in our modern economy, see Harry Scherman, *The Promises Men Live By.*

In the second place, producers' credit may provide productive use for the savings of people who do not themselves wish to engage in productive enterprises. In order that wealth shall be created, there must be savings—an excess of production over consumption—and the productive investment and use of those savings. These functions may be combined in one person, as in the case of a farmer who saves and invests his savings in better farm equipment, or they may be performed by different individuals; but less would be saved if savers could not lend, and there would be less wealth.

Producers' credit, in the third place, probably increases production and wealth by facilitating the organization of large business undertakings. It is true that some such undertakings have borrowed too freely. The railroads and public utilities have too much of their capital structure in the form of bonds—debt—and as a result are often in trouble, just like small borrowers. On the whole, however, it is probable that the use of productive credit has increased production in this way, and therefore has added to wealth.

Consumers' credit

Consumers' credit is a horse of a different color. Many of the loans of medieval times were consumers' loans, advanced to people in dire distress and with dire results; and even today there are some such loans, usually carrying very high interest rates and secured by chattel mortgages. Loans on installment payments, many of them for the purchase of automobiles, radios, furniture, clothing, and other consumers' goods, have grown rapidly in recent years, and at times have reached a total of 9 billion dollars. Wise people seldom resort to installment loans, because wise people are afraid of any sort of debt and because the rate of interest is generally extremely high—from 12 to 20 per cent. Furthermore, buyers are in a much better position to judge whether a thing is worth buying if they pay cash than if they make a "small payment down" and pay a "small amount each month." A man who looks at a new refrigerator and then looks at his $175 is weighing the relative importance of the two things between which he must choose. If he decides that the refrigerator is worth more than $175, he can buy safely; if he concludes that it is not worth $175 to him, he will not buy. But if he is comparing the refrigerator with "$25 down and a small payment each month," he loses his perspective. He may even have half a notion that the refrigerator costs only a little more than $25, and that the "small payments" will somehow take care of themselves; or he may have a vague hope that he will soon get a raise in salary or perhaps find a pot of gold under the cellar steps. At any rate, he is not making the right comparison, which is between the refrigerator and his $175. So installment credit tends to encourage overbuying.

It is sometimes assumed that consumers' credit speeds up production by accelerating the purchase of goods, but as a general proposition this is an error. Through the use of credit, the borrower is indeed able to buy goods sooner than he could if he had to wait until he accumulated the necessary savings—in fact, borrowers in general can buy goods sooner than they could without the use of credit—but in a society which uses credit and *is not increasing the amount of credit,* there must be as many borrowers paying their debts as there are borrowers receiving loans. Those who are paying their loans are of course obliged to restrict their purchases as much as the new borrowers are enlarging theirs; hence there is no net increase in purchasing. During the time that consumers' credit is increasing, there is a greater demand for consumers' goods than there would be if credit were not used; but in a period of depression, when borrowers are being forced to repay their loans, there is correspondingly less demand. If consumers never bought goods "on time" but always accumulated enough cash to buy what they wanted, they would buy the goods produced approximately as fast as they now do. In a perfectly functioning economic system, goods would be bought as fast as they could be produced, regardless of whether credit was used or not.

Credit and economic instability

The use of commercial credit, both consumers' and producers' credit, makes the economic system more unstable, more subject to extreme fluctuations than it would otherwise be. Through the use of consumers' credit, particularly installment credit, consumers buy heavily in times of optimism, far more heavily than they could if they had to buy for cash. In a period of prosperity and optimism, credit rises sharply; then when a depression strikes and the demand for goods would be light anyhow, it is further restricted by the fact that consumers are obliged to make installment payments out of reduced incomes or lose the amounts already paid. Some of them manage to make their payments by skimping on the purchase of other goods; but others turn their radios, furniture, rugs, and automobiles back to the retailers or finance companies, thus liquidating the debt but adding to the supply of goods on an already oversupplied market.

In somewhat the same way, credit makes productive business more unstable, for in times of prosperity and optimism many businessmen incur debts for the purchase of raw materials and merchandise or for the expansion or improvement of plant; and in depression times the repayment of these loans makes necessary a sharp curtailment of expenses all along the line, and a consequent deepening of the depression.

Other classifications of credit

Credit may also be classified with respect to the time within which payment may be made; on this basis it is called short term, long term, and intermediate. For the purchase of raw materials or merchandise, a businessman ordinarily secures short-term credit, running from one to six months, from a commercial bank. For building up a herd of cattle or buying a bunch of "feeder" cattle to fatten, a farmer may want intermediate credit that runs from six months to two or three years. For the purchase of a farm he usually has to have long-term credit running for at least five years and possibly much longer; some farm mortgage loans run as long as thirty years. Similarly, an industrial enterprise, in need of funds with which to finance an expansion of plant, will secure long-term credit, perhaps by issuing bonds that run for five or ten years or even longer.

Credit may be classified, finally, with respect to the agency providing it. This may be an individual money lender, a person who has more funds than he needs for his own uses. Most of the lending during the Middle Ages was done by individual money lenders, many of them Jews; and even today there is some of this type of credit, as for example loans among members of a family, and by "loan sharks" to necessitous borrowers who cannot get credit at a bank. Much credit is also extended by nonbanking business concerns such as retailers and wholesalers and by great industrial firms, but much of this credit ultimately comes from banks. Some retailers regularly provide credit until the end of each month, and some sell on the installment plan, with payments to run a year or more. Wholesalers often extend credit to retailers in somewhat the same way that retailers do to customers. Recently some of the great industrial giants, like General Motors, have lent hundreds of millions in the New York "call" market, and insurance companies are heavy lenders on bonds and mortgages.

Bank credit

Credit may be extended by various types of banks and financial institutions. Most of the short-term commercial credit and some of the intermediate and long-term credit are provided by the banks. Finance companies handle various kinds of loans, on automobiles and other chattels, which were once thought hardly proper for banks; but in recent years the banks have entered this field to some extent. Credit may also be provided, immediately by investment banks, but finally by the investing public when these banks buy the bonds of a corporation and sell them to the public.

Credit extended by a commercial bank differs fundamentally from credit advanced by an individual. An individual can lend only the amount of his own savings; but a bank does not have to limit its loans to the amount of its own or its depositors' savings. With a given amount of cash reserves, it can lend several times as much in bank credit in the form of bank notes or bank deposits, in this way operating as a "manufacturer of credit." The manner in which this is done will be made clear in our discussion of banking.

Development of banking

The commercial banking business as we know it grew out of certain functions of the goldsmiths, in the late Middle Ages. Some goldsmiths had safes or vaults in which they kept the gold and silver which they used in their work; and to them the merchants brought their surplus gold and silver coins for safekeeping, receiving in return receipts which entitled them to the amount of coins they had deposited. In time the goldsmiths adopted the custom of issuing these receipts for certain *standardized* amounts of gold or silver, and later it became common practice for holders of such receipts to use them as money. The gold and silver remained in the goldsmiths' vaults, but the receipts passed from hand to hand as money, although they had to be endorsed. Except for the need of endorsement, they were representative money like our gold and silver certificates. They did not increase the amount of money in circulation but merely circulated in place of the gold and silver coins, thus saving wear and abrasion and some inconvenience; but the depositors had to pay the goldsmiths for storing these coins.

In time, some of the goldsmiths found a way to increase their profits by expanding the number of receipts above the amount of gold and silver actually in their vaults. Some gold and silver was brought in for storage from time to time and some was taken out, but seldom was there a demand for more than 10 per cent of the total at any one time; and the goldsmiths developed the practice of lending credit to merchants and traders in excess of the amount of gold and silver in their vaults, taking mortgages on property owned by these men as security. All this enabled the goldsmiths to make larger profits, and it also increased the amount of purchasing power in the community, because the credit extended in this way was used as "money" in commercial transactions. In time the goldsmiths began also to issue their personal notes against their gold and silver deposits. These notes were payable in gold or silver, bore no interest, and passed from hand to hand without endorsement. Here were the fundamental functions of banking—lending, and creating credit—already fairly well developed before modern banks were established.[2]

Different kinds of banks

There are a number of different kinds of banks: commercial banks—national and state—savings banks, investment banks, and trust companies. *Commercial banks* represent the banking business typically. Their characteristic functions, until very recently, were to provide deposit checking facilities and make short-term loans to businessmen. Today they provide a variety of services for their customers and also for others. By buying bonds they extend long-term credit to corporations and government units; they usually have connections through which, for a certain commission, they extend long-term mortgage credit, or they may lend some of their own funds; they commonly advise customers as to the investment of their savings, and in some cases sell them securities or mortgages, perhaps from their own holdings; they sell drafts and bills of exchanges and travelers' checks; and many of them provide their customers with safe-deposit boxes at a small rental.

Savings banks do not accept ordinary checking accounts but confine their operations largely to taking care of the savings of people of small and moderate means. Accounts in such banks may be withdrawn only on 30 to 90 days' notice, and they draw a very moderate rate of interest, because these banks can invest only in conservative securities and mortgages under more or less strict regulation by the states.

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[2] See Russel A. Dixon, *Economic Institutions and Cultural Change*, pp. 120–124.

There are only a few *investment banks,* in the large cities, but their business runs into big figures. Their function is to secure funds for large business concerns for permanent investment. A business enterprise which wants additional funds for plant expansion or improvement in equipment may issue 10 million dollars in stocks and sell them to an investment bank, say Morgan, Stanley & Company, or Kuhn, Loeb and Company, who in turn manages the sale of the stocks to the investing public. If the issue of securities is very large, the investment bank may invite other banks to participate and help sell the securities.

Trust companies engage in many kinds of financial activities: ordinary commercial banking, the care of savings, and insurance and safe deposit business. They also act typically as trustees; that is, they attend to the management of trust funds set up for philanthropic, charitable, educational, or private purposes. Sometimes wealthy men create trust estates for their wives or children, the income to be paid to the heirs after the creator of the trust dies, and a trust company managing the investment of the funds and the payment of the income to the heirs. This is often a better way to provide for dependents than to bequeath money or property by will, because the officers of a trust company are generally better qualified to handle funds and property than a widow or children; yet trust companies have sometimes made costly mistakes in investments and have occasionally charged exorbitant fees for their services. In the growing importance of trust funds we see again that characteristic drift of our modern economy, already observed in the corporate form, the separation of property ownership from management.

Functions of commercial banks

The two main functions of the commercial banking system, as usually outlined, are (1) the *money function,* the providing of deposit money for convenience in making payments, and (2) the *loan function,* the providing of credit for borrowers. There is also a third function, that of *caring for savings,* which the banks share with certain other agencies.

The money function. The money function of commercial banks is the providing of money, the means of making payments, through bank notes or bank deposits. The issuance of notes is best known historically, for bank notes constituted much of the country's monetary supply before the Civil War, and a considerable proportion thereafter. These notes were merely *debts* of the banks, but were supposed to be backed by a cash reserve of from 15 to 25 per cent. At the present time no bank notes are being issued. The recent tendency has been toward the use of bank deposits, which for some purposes are more convenient than bank notes.

Bank deposits are essentially like bank notes. Both notes and deposits are money in the broad sense of the term; both are debts of the bank. A loan of either is an exchange of bank credit for personal credit (because the borrower gives the bank a note when he borrows). The borrower pays interest because the credit of the bank has more general acceptibility than his own.

Bank deposits do not represent primarily money "deposited" with the banks, as the word seems to indicate, although they occasionally do arise from deposits of cash or, more often, of checks drawn on other banks. If banks held only cash deposits, they would operate as mere safety deposit vaults and would have to make a charge for the service as the goldsmiths did —and as the banks themselves have done in very recent years, for reasons which will appear presently. If the banks lent only the savings of depositors, they would create no additional money, or purchasing power, but would merely manage the transfer of purchasing power from savers to borrowers. Only a small portion of our total bank deposits normally arises in this way, and these deposits are not held chiefly in cash. In normal times, most bank deposits represent credit created by the banks in lending to businessmen or, more recently, to the federal government.

To insure prompt payment of deposits, banks carry *reserves* of from 7 to 20 per cent of the amount of their deposits. At one time they carried these reserves in cash, either in their own vaults, in other banks, or in Federal Reserve banks, but now all national bank reserves are kept in Federal Reserve banks.

Depositors can either withdraw their deposits in cash or draw checks against them. The latter, which is much more common, not only is a great convenience but is safer than the use of cash in making payments. It obviates carrying large amounts of cash—always a risky business—and provides receipts in the form of canceled checks.

If one depositor draws a check in favor of another depositor in the same bank, the process of making payment is simple. The payee may cash the check at his or another bank or, much more likely, deposit the check at the bank, in which case the bank merely transfers the amount of the check from one account to the other. If the drawer of the check and the payee have accounts at different banks in the same town, the check will have to be *cleared,* but this process is not very complicated. Every bank in a town ordinarily receives for payment a number of checks drawn on its own accounts, and for deposit a number of checks drawn on accounts in other banks; and every day representatives of the various banks meet at the *clearing house* to balance the debits and credits arising from these checks. Usually there is something approximating a balance, and any net differences between credits and debits are settled in cash, or perhaps temporarily in some other way. In the New York clearing house it is not unusual for several hundred million dollars in checks to be cleared in an hour or so.

A check may, however, be drawn in favor of someone living in another part of the country. This may happen, for instance, when a man in Colorado orders a book from a New York publisher, sending his check, drawn on a Denver bank, in payment. Here the clearing of the check, although somewhat more complicated, involves essentially the same process. Checks are cleared mainly through the Federal Reserve banks. Most banks have accounts with one of the Federal Reserve banks, and the checks are cleared by a process of balancing the debits and credits of the various banks. It is somewhat more expensive than clearing checks in the same town, for the checks must eventually be mailed to the bank on which they are drawn.

The money function of the commercial banking system is performed with great efficiency and is a very convenient service to depositors. Until recent years, the banks made no charge for handling checks; but they now have a schedule of charges for this function, in justification of which they claim that their loans to businessmen are no longer large enough to afford them a reasonable revenue. Whether the charges are generally too high is not certain. In some parts of the country the banks have construed the phrase "reasonable revenue" rather liberally; yet it is not unreasonable for them to charge what the service costs. When they cleared checks without charge they did so at a loss which had to be balanced by compensating profits on loans. It would probably have been fairer to make check clearing pay its way and reduce interest rates on loans. At present, vast bank loans to the federal government have to some extent compensated for the decline of loans to businessmen, and most banks are doing fairly well, some of them very well indeed.

Unfortunately, the use of deposit money has tended to increase the instability of our economic system. More than 90 per cent of all payments, by volume, are made by checks on deposits, and the amount of deposit money varies widely from time to time because the number of business loans made by banks varies with business conditions. Variations in the amount of deposits are important factors in the business cycles with which our economy is perennially plagued.

The loan function. The loan function of banks has already been mentioned in our discussion of credit. It is from banks, mainly commercial banks, that businessmen receive the credit needed in their operations, particularly short-term credit. To some extent the banks lend the savings that are deposited with them, but to a greater extent they create the credit which they lend. A merchant who needs $5000 to buy a stock of merchandise may arrange for a loan at his bank, giving the bank a promissory note payable, let us say, in three or six months, at the end of which time he will presumably have sold the goods and will be able to pay the loan, retaining for himself whatever profit he may have made. Or a wholesaler may have sold a bill of goods to a retailer, receiving in payment a note payable in thirty days. The wholesaler may not wish to carry on a credit business, and is likely to take the note to his bank and have it *discounted.* If the note bears no interest, the bank will discount it at say 6 per cent per annum, paying 94 cents on the dollar on an annual basis, or 99½ cents on 30-day paper, and hold the note until maturity, when the retailer is assumed to pay it. If he does not pay it, the wholesaler must, for he has endorsed it at the time it was discounted. If the note bears an interest rate of 6 per cent the bank may pay the wholesaler face value for it.

What is the point of this exchange of personal for bank credit, in which only the borrower pays interest? Why is the borrower willing to pay interest in such an exchange, an exchange of his own credit for that of the bank? The answer is that his own credit is not as good as that of the bank. If it were, he would not need to resort to the bank but could buy what he wants on his own promise to pay. Furthermore, he can check on his bank deposit at any time, whereas the bank cannot call for payment of his note until maturity.

Since the banks make a large part of their income from interest on loans, they have an incentive to expand loans as far as possible. Their reserves are dead assets which earn nothing. What sets the limit to the amount of loans that they can make? In the first place, the banking law requires them to keep a certain percentage of reserves against their deposits. In the Federal Reserve System, these reserves are now held in the form of balances with the Federal Reserve banks, rather than as cash in their vaults, but this makes no fundamental difference in the situation. If the law requires 10 per cent reserves, a bank with $100,000 in cash reserves can create only $1,000,000 in deposits theoretically, and less in actuality. In the second place, business caution may suggest limits to the amount of loans, limits even lower than those established by the law. In a period of reckless business enthusiasm, conservative bankers may well hold their loans below legal requirements, and they may even follow the policy of calling in loans and building up the bank reserves in anticipation of a business crisis. Although this means a reduction in immediate income, it may in the long run be wise, because it minimizes the danger of overextension and failure and gives the banks a reputation for stability and soundness which is a very valuable asset. In the third place, bank loans are limited to the amount that customers want to borrow, which in recent years has been far below the limit set by reserve requirements. During the Great Depression, the loans of many banks declined to a point where their reserves were equal to their deposits and they could have paid all depositors in cash at any time. This meant, of course, that their loan function had dwindled to one of minor importance and that their receipts from the interest on loans were very low. As a result largely of this, they adopted the policy of charging depositors for handling checks; they have backtracked to a business somewhat like that of the early goldsmiths.

This decline in bank loans began even before the onset of the depression in 1929. Between 1921 and 1938 short-term loans declined from 70 per cent of all loans and investments to 34 per cent, a drop of more than 50 per cent. In 1938, two-thirds of all commercial bank loans and investments represented government bonds, corporation securities, and real estate loans. Unable to make enough short-term commercial loans, the banks have turned to loans for a longer period—two or three and even ten or fifteen years—and they have invaded some fields of credit not formerly thought proper for bankers, such as personal consumers' loans, loans on life insurance policies, and home mortgage financing, among a variety of others.[3]

Most of the short-term lending is done by commercial banks, but trust companies and installment finance companies also make this type of loan; and a number of other agencies make long-term loans—investment banks, mortgage companies, and insurance companies. The latter are loans of investors' savings, not of deposit credit created by these institutions, and they therefore have no tendency to increase purchasing power and raise prices. Also, as we shall see presently, several kinds of government banks are engaged in making loans to various classes of borrowers.

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[3] See Temporary National Economic Committee, *Monograph No. 37,* pp. 60, 61.

The caring for savings. In ancient and medieval times, people held their savings largely in the form of coins or jewels, or in cattle or slaves or wives or other personal property; but the problem of conserving these savings was a difficult one, and the risks of loss were very great. Today, although the risks are still great, the problem is at any rate less difficult, for banks and other savings institutions provide convenient means of caring for savings.

Savings may be either temporary or permanent. Many people save small sums from time to time, not for permanent investment but for later expenses. Many men who receive a month's salary on the last day of the month use most or all of it for expenses before the next check comes; farmers selling livestock or grain have a cash surplus which they ordinarily use to pay expenses until the next crop is sold; merchants receive their income from daily sales, and must hold at least a part of it to repay borrowed money or buy new stocks of goods. Since no one gets his income at just the rate at which he pays his expenses, he must have some sort of surplus in fat times to cover the deficits of lean times—he must have some temporary savings. In some pioneer communities, before banks appeared, the settlers kept such savings in the form of cash which they hid somewhere about the premises. Today the banks, mainly the commercial banks, offer good facilities for caring for such savings, and their total amount runs into many billions.

Not all the savings deposited in the banks are to be regarded as temporary. Some depositors use bank accounts for long-term savings, building up their accounts to buy a home or a farm or to insure against penniless old age. Usually they have their savings in savings accounts rather than checking accounts, for until recently savings accounts drew a small rate of interest; but a small part even of checking accounts is maintained for years.

Savings institutions

A number of agencies are engaged in caring for long-term savings: commercial banks, mutual savings banks, investment banks, investment trusts, building and loan associations, life insurance companies, corporate and individual trustees, and postal savings banks (operated by the federal government). The total assets or funds in all these various institutions amounted to more than 66 billion dollars in 1939, and they more than doubled during the war.

Commercial banks. Commercial banks deal for the most part with checking accounts and short-term loans, yet they carry large amounts of time deposits—20 billions in 1945. These banks provide a convenient means of handling savings, but in the past there have been heavy losses through bank failures.

Savings banks. Savings banks reported more than 13 billions of funds in 1939. The depositor in a savings bank, as in a commercial bank, holds his investment in the form of a deposit, which is a debt of the savings bank to him. The bank stands between him and the securities it buys with his savings, and guarantees the safety of the investment, earning a small margin between the yield of the securities and the interest paid the depositors. The depositor deals only with the bank and knows nothings of the investments into which his savings go. The record of savings banks, as to integrity and safety, is generally exemplary.

Investment banks. Investment banks operate on a different principle. They sell the saver a stock or bond or other security, and then their responsibility ends. If the security turns "sour," the loss falls entirely on the investor, although presumably the bank will "regret" such an unfortunate denouement. Investment banks sell most of their securities to persons of greater financial resources than the depositors in savings banks, and they sell vast amounts to trustees and other corporate investors.

In the investment banking business we can see some of the most characteristic features of capitalism in its advanced stage. The business is highly concentrated in a few big firms, most of them in New York City. The National City Company alone handled some 20 billion dollars' worth of securities in the ten years between 1922 and 1932; and in a single year, 1929, more than 10 billion dollars passed through the investment banks of the country. The business is monopolized, for these banks do not compete aggressively for business; until recently they did not compete at all but divided the market.

With the business to some extent monopolized, it is not surprising that the commissions charged have on the whole been fairly high. Often there are three different agencies between the financing corporation and the public investors: the original group of investment bankers, an intermediate group, and finally a selling group of hundreds of retail investment dealers who sell the securities to the public. The total commissions of all these groups range from less than one point to as much as eight or nine, or even more. That is, a corporation issuing bonds at $100 might receive more than $99 or as little as $91 on each bond sold, and in a few cases even less, the rest going to the bankers and dealers as commissions.

Partial monopolization is not the only charge against the investment banks. Some of them have been so closely identified with commercial banks, through interlocking directorships and stock ownership, as to be practically identical with them. This was true until recently of the National City Company (an investment bank) and the National City Bank, which were practically identical institutions. The banking business should be very conservatively managed; but the affiliated investment bank in this case was a huge organization selling bonds and stocks by means of sales tactics quite unworthy of the investment business, or any business. This investment bank, like some others, did not serve as a careful, judicious adviser of investors; rather it was a high-pressure sales organization, selling its wares with little intelligent regard for their soundness. Several investment banks actually sold, and required their salesmen to sell, securities that they knew were not good investments. Hundreds of millions in such securities were unloaded onto the public, with consequent heavy losses to investors. The records of some of the investment banks are in some respects incredibly bad, but the government is now trying to secure the elimination of some of the worst practices.[4]

The business of the investment banks has declined greatly in recent years for two reasons. In the first place, since the onset of the Great Depression, but of course before the outbreak of World War II, business has been generally sluggish, and there has been a reduced demand for investment funds; and in the second place, many big corporations recently have been able to do their own financing out of their own profits. In the realm of big business, both in the United States and also in some foreign countries, industrial concerns are less dependent on the banks than they used to be, apparently for both short-term and long-term loans.[5] Even when corporations need outside funds they often sell their securities directly to investors, particularly to banks, insurance companies, trust companies, and other trustees. Such institutions are the most important buyers of high-class securities.[6]

Investment trusts. Investment trusts have operated in Great Britain since about 1860, but their rapid growth in the United States began only about twenty years ago. They hold a great diversity of securities, and the investor buys certificates which entitle him not to any specified amount of money return, as in the case of a savings bank or insurance company, or to any particular securities, as in the case of an investment bank, but to a certain share of the earnings of all the securities owned by the company. The advantage held out to the investor is wider diversification in investments than would otherwise be possible for the ordinary investor, and therefore greater safety. Some securities will inevitably turn sour, but the theory is that these will be balanced by others which prove exceptionally good, and the investor will thus have a safe but moderate return. Of course he receives only what the securities yield, minus the expenses of carrying on the investment trust.

The theory behind the investment trust business seems sound. Not only does this form of enterprise offer wide diversity in investments, but it should be able to employ better judges of security values than most individual investors could find. American investment trusts have not lived up to the best possibilities of the business, however, and losses to investors have been heavy, partly because of the unprecedented severity of the Great Depression, which caused heavy losses in most investments, and partly because of poor judgment, mismanagement, and even occasional outright crookedness on the part of trust officials. In some cases officials have dissipated the resources of the trusts by speculating in stocks; in others they have exploited investors by shuffling the securities behind the scenes, taking the better ones for their personal accounts and leaving the "lemons" for the investors; and on the whole they have treated themselves generously in the matter of promoters' fees, salaries, bonuses, and other "valuable considerations." Standards of management have risen in recent years, and the worst vices are probably less common than they were; but investment trusts have a fairly bad record to live down.

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[4] On the practices of investment banks at their worst, see Julian Sherrod, *Scapegoats.*

[5] See Temporary National Economic Committee, *Monograph No. 37*, pp. 50–60.

[6] *Ibid.*, pp. 61–65; Temporary National Economic Committee, *Hearings*, Part 9, pp. 3814–3818.

Building and loan associations. Building and loan associations, whose function is largely that of turning the savings of local investors in building and loan stocks to the construction of homes, had 12 million members in 1930 and assets of $8,800,000,000, which had declined to about 6 billion in 1940. These companies are generally regulated closely by law, have usually been fairly conservative in their policies, and before the Great Depression had an excellent record in their investments. With the drastic decline in property values after 1929, however, a considerable number of them failed, with resulting losses to investors.[7]

Life insurance companies. Life insurance companies do not function merely as investors of the savings of their policyholders. They also serve to *insure* these policyholders against the chance of leaving dependents without support in case of death. Part of the premiums paid by the holders of policies goes to pay for the risk of death, and in most types of life insurance part goes to build up what amounts to an *investment.* The investment element varies with the kind of policy, being practically nothing in what are called *term policies* (which run for only a certain number of years and are intended only as insurance for the period covered), but in others—endowment policies, for instances—being the most important feature. In this chapter we shall consider life insurance companies in their function of caring for savings.

Life insurance is a tremendous business. In the United States in 1939, there were 365 "legal reserve" life insurance companies, with total assets of more than 28 billion dollars, and with 124 million policies outstanding, representing a total face value of about 111 billions. The annual income of these companies at that time was more than 5 billions, almost equal to the normal receipts of the federal government. In the ten years from 1929 through 1938, these companies received a total income of more than 30 billions from premiums, and made investments of more than 26 billions. As in many other kinds of business, a few companies do a large share of the total business. The two largest, the Metropolitan and the Prudential, with assets of a little less than 5 billions and 4 billions respectively, do about 32 per cent of the total business, and the five largest companies account for more than half.

The insurance companies have done a fair job in some respects. Relatively few of them have failed, and the liquidation of those that have failed has not always resulted in losses to policyholders. Many men find their insurance policies a great comfort when other investments fail. Even when they are obliged to surrender their policies for whatever cash surrender value they may have, they often find them a better than average investment, for most investors lose a great deal; and of course the protection for dependents is worth a great deal.

The most serious fault in the life insurance business lies in the fact that a large proportion of the policies "lapse" or are surrendered, with consequent loss to the holders. (An insurance policy lapses when the insured fails to keep up his payment of premiums.) In the ten-year period from 1928 to 1937, less than 22 per cent of the 126 billion dollars in life insurance policies were terminated by death, maturity, or expiration, as against more than 78 per cent that lapsed or were surrendered. This means that over 78 per cent of the insurance failed to "fulfill the principal purposes for which it was intended." While such policies were in force they did afford protection, but at a high cost, for with most policies the holder pays more than the risk is worth during the first few years that his policy is in force, and less than the risk is worth in the later years. When he allows the policy to lapse or surrenders it, he loses something because of this; and in addition he loses whatever it cost to put the insurance on the books—the agent's commission and other overhead expenses.

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[7] Temporary National Economic Committee, *Hearings,* Part 9, pp. 3728, 3737, 3739.

The loss from lapsed and surrendered policies is particularly heavy in industrial insurance. Industrial insurance is like ordinary life insurance in most respects, but it is sold largely to laborers and people of small incomes and for various reasons is more expensive. Agents go to the homes of the policyholders every week or every month to collect the premiums; and since no medical examination is required, the risk and therefore the premium are higher than in ordinary insurance. In 1937 there were 88,900,000 such policies in force, representing more than 20 billions in insurance. Nearly 95 per cent of them terminate by lapse or surrender, with even heavier losses than are incurred in dropping ordinary life policies. Only about 5 per cent of the industrial policies are held until death or expiration, and so accomplish the major purpose of insurance—a record little less than scandalous.

Some lapses and surrenders are inevitable, but the extraordinary percentage of such failures must be attributed in some measure to bad business practices. The companies, and the agents who sell insurance, make their profits from sales, and they often use high-pressure sales tactics to get the maximum amount of business on the books, unload policies on people who have little chance of carrying them to death or maturity, and sometimes sell people more insurance than they can safely carry. Life insurance, with its requirement of regular and uninterrupted payment of premiums over many years, can be bought safely only by those with fairly reliable incomes; but some salesmen sell all they can to all who are susceptible to their sales pressure. The industrial insurance business should not be tolerated at all; instead, the government should provide social insurance for such workers, as it is now doing. In fact, some students of the problem insist that the entire insurance business should be taken over by the government. The federal government provided insurance for men in the military forces in World War II as it did in the First World War.

In many aspects the insurance business is much like other kinds of big business. It has important monopoly elements—agreements as to rates, for instance; rates are handsomely high, and some of the companies have been extraordinarily profitable. As in all large corporations, the officers and directors have practically absolute control of the companies, and in some cases have changed the form of corporate organization to promote their personal interests. The directors usually do not pay much attention to the business, perhaps attending directors' meetings only on rare occasions. Some officers and directors have used their official positions for personal gain, as in borrowing funds belonging to their companies. Interlocking directorships are common. In 1938, the twenty-six largest insurance companies owned 4.5 billions' worth of United States bonds, more than 2 billions' worth of railroad bonds, almost 3 billions' worth of public utilities bonds and stocks, 4.5 billions' worth of mortgages, 1.75 billions' worth of real estate, and various other investments—altogether, more than 24 billions in bonds and property. Investing several billion dollars each year, insurance companies are a formidable power in the investment market.[8]

Trustees. Corporate and individual trustees, altogether about 183,000 of them, control about 50 billion dollars of savings, invested in various kinds of securities and property. Some act as trustees of the estates of men who have died, or of other property; but corporate trustees—trust companies, great charitable organizations like the Rockefeller Foundation and the Mellon Fund, and some endowed colleges and universities—account for the great bulk of the business. Here, as almost everywhere, the corporate form has supplanted the individual more and more.[9]

History of commercial banking

Returning now to a more careful consideration of commercial banking, we must consider its history briefly. In the early history of the United States, banks were chartered by the states, or they were private, that is, they were not chartered as banks but were individuals carrying on a banking business. In either case they were subject to little regulation. They issued notes at will and often in reckless amounts, with the result that there were many failures and heavy losses to holders of these notes. The First Bank of the United States, established by Alexander Hamilton in 1791, held something of a check on note issue by refusing to accept the notes of banks which were not currently redeeming their own issues in specie; but the country had not learned the essentials of sound banking. Capital was scarce in the new country, interest rates were high, and, except along the eastern seaboard, the people generally hankered for the red wine of "cheap money," however much they had suffered from too much of it. Furthermore, state banks resented the restrictions of the federal bank, and in 1811 it was refused a renewal of its charter. After its expiration, state banks sprung up again with mushroom rapidity, many of them correctly characterized as "wildcat" banks. In 1816 the Second Bank of the United States was set up, and for twenty years it exerted a salutary if not very rigid control over state bank note issues; but in 1832 its president, Biddle, became involved in a political row with President Jackson, as a result of which its charter was not renewed. Thus a free field was again left to the state banks until the time of the Civil War.

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[8] Temporary National Economic Committee, *Monograph Nos. 28, 37; Hearings,* Parts 4, 8, 10A, 12.

[9] Temporary National Economic Committee, *Monograph No. 37,* pp. 19 ff.

During the Civil War there was need for a better banking system, and also for a market for the bonds that the federal government was issuing to finance the war, and as a result the National Banking System was established in 1863. To eliminate the chaos of wildcat bank notes, an amendment in 1865 imposed a 10 per cent tax on state bank notes; and to provide a market for federal bonds, it required the national banks to buy and turn over to the Treasurer of the United States bonds equal to one-third of their paid-up capital. On the basis of these bonds they might have the Comptroller issue bank notes. Here were bank notes of unquestioned soundness, for they were backed by government bonds, the obligations of the government itself. The National Banking Act also specified requirements as to the amount of reserves that were to be carried by the banks, and provisions for examinations by the Comptroller of the Currency.

Faults of the National Banking System

The National Banking System was in most respects a great improvement over the state banking system of the period before the Civil War, but it was criticized on various grounds. In the first place, the national bank notes, although absolutely sound, were almost entirely inelastic in supply, with no tendency to expand or contract with the needs of business. Elasticity was greatly needed at certain times. For example, each year in the farming states, there was always need for additional money at harvest time with which to move crops into the central markets. Unless the banks in these states had reserves considerably above the legal requirements, they could not provide the credit and cash needed; in other words, seasonal elasticity was lacking. In times of financial crisis too, when debtors were being pressed for the payment of loans, or were being closed out no matter how strong their general financial rating, the banks were unable to help, and even called in their own loans and accumulated cash. They were bound to do this in self-preservation, for every bank was potentially insolvent because it did not have enough cash to pay all its depositors if they all demanded payment at once, as they were likely to do in times of panic. Thus, when money was most needed to ease the stringency in money and credit, the banks were unable to expand their notes because they were based on United States bonds, the supply of which was inelastic, or in some cases "perversely elastic," that is, tending to increase when least needed.

This inelasticity of bank notes, while often urged as a serious flaw in the National Banking System, is not considered serious by most monetary authorities today. Many authorities now believe that business conditions would be more stable if the money supply did not vary so much.

A second fault charged to the system was that it did not provide much elasticity of credit, because the reserve requirements were rigidly fixed by law, and there was no provision for converting commercial paper—loans and discounts—into cash. As to reserves, the banks were required to maintain them in certain fixed amounts; and no matter how great the need for additional credit, they could not fall below this fixed limit. This would not have been serious if in case of need the banks could have taken some of their good commercial paper to a central bank and received cash for it through the process of rediscounting; but there was no bank, central or otherwise, from which they could get cash for commercial paper.

This inelasticity of credit, like the note inelasticity, although often criticized by economists some years ago, is not regarded as a vice by most monetary students of today. Some now insist that our banking system has always provided too much credit elasticity rather than too little, and that banks should be required to carry 100 per cent reserves and should not be permitted to expand and contract credit. It is often argued that if money and credit were maintained at a fairly stable level, the fluctuations of the business cycle would not be so severe.

A third and very real fault of the National Banking System appeared in the fact that some of the bank reserves were sent to a few large banks, mainly in New York City, which lent them "on call" to speculators in the stock market. Under the act setting up the system, banks were divided into three classes: (1) central reserve city banks, including the national banks in New York, Chicago, and St. Louis; (2) reserve city banks; and (3) country banks. National banks throughout the country were permitted to keep part of their cash reserves in banks in central reserve cities; and they generally did this, because they got a small rate of interest from these banks and could thus eat their cake and have it too. Thus part of the reserves of the national banks throughout the country gravitated to New York, chiefly into half a dozen of the largest banks there, which lent them to stock market speculators. These New York banks did not recognize any heavy responsibility in handling these reserves; they did not carry heavy excess reserves as a guaranty of the prompt return of the borrowed money on demand, but kept only a little more than the law required. The assumption was that if any of the smaller banks wanted their reserves they would call on the central reserve city banks, which would call on the stock speculators, who would sell their stocks and repay their call loans, and the big banks would promptly send back the reserves to the banks from which they had come. Everybody would be happy except the stock speculators; and since one of the important functions of the stock market was to shear the lambs that wandered in there, nobody worried about that.

In normal times, this worked out fairly satisfactorily; but in a panic the system sometimes broke down. In 1907, for instance, people all over the country became panicky and started runs on some of the banks. Thereupon nearly all the banks in the country called back their reserves, and the New York banks called upon the stock speculators for several hundred million dollars at once; but the speculators dumped so many stocks on the market that it broke disastrously and they could not pay back their call loans, the New York banks could not send back all the reserves, the smaller banks could not pay their depositors, and presently we were in the midst of a financial panic. Centralization of reserves in New York in normal times, and decentralization during a crisis, sometimes brought disastrous results.

A fourth difficulty with the National Banking System was that there was no controlling agency to assume responsibility for the system as a whole, to head off unwarranted optimism and unwise expansion of credit in prosperous periods, and to save the banks from disaster in times of panic. Every bank was assumed to be able to order its own course and to stand on its own feet in good times and bad, although such an assumption was clearly unjustified. No bank lived to itself; no bank could maintain its solvency if other banks were in trouble, no matter how conservatively it had been managed, for a bank panic, once well under way, is difficult or impossible to stop. If the depositors started a run on one bank, that bank was of course unable to pay all of them at once from a cash reserve of 15 to 25 per cent, so it was soon obliged to stop payments and close its doors unless neighboring banks could provide enough cash for the emergency. Other banks usually helped, if the one in trouble was fundamentally sound and had only good loans outstanding; but sometimes the other banks could not help enough, and the bank had to close. This generally led to widespread suspicion of all banks and to runs on neighboring banks, with the panic spreading quickly over the entire country and almost all banks forced to close. It was much like a fire in a city that has no fire department to put out the flames when they first appear.

These defects, alleged and real, were brought into clear light by the panic of 1907 when most banks were closed; and a movement was soon on foot to secure a revision of the banking system. The remedy most often suggested was a large central bank like the Bank of England, the Bank of France, or the German Reichsbank, a big central "bankers' bank," to some extent government-controlled, with large cash reserves and some power of control over the entire system. Such a bank, however, would probably have been located in New York City, the financial center of the country; and this was opposed by many Congressmen from the western and central states, who, always more or less suspicious of Wall Street, were unwilling to see New York's financial power increased. For this and other reasons, banking reform made little progress until Woodrow Wilson's administration, when the Federal Reserve System was established.

The Federal Reserve System

The establishment of the Federal Reserve System was politically possible because, instead of setting up one great central bank in New York City, the law provided for twelve Federal Reserve banks, one for each of the twelve districts into which the country was divided,[10] and a Federal Reserve Board, now known as the Board of Governors, to coordinate and regulate the twelve units. Patterned after the central banks of Europe, Federal Reserve banks are bankers' banks, controlled by the member banks and the government. It will be pertinent to see how the new banking system was designed to correct the faults of the National Banking System outlined above.

The inelastic bank note issue has been largely replaced by Federal Reserve notes issued by the Federal Reserve banks. These notes are elastic enough to meet the varying needs of business because they are backed by a 25 per cent reserve of gold certificates, and, for the remainder of their face value, by government bonds or commercial paper; or they may be backed entirely by gold certificates. If a member bank that is threatened by a run is in a sound condition, it may take its good commercial paper and government securities to its Federal Reserve bank, have them rediscounted, and receive enough cash to pay all its depositors; and of course if the depositors can get their money they are likely to turn around and put it back in the bank again. Many banks, even those that had been managed fairly well, did indeed fail in the crisis years of the Great Depression; but this occurred because assets that had seemed fairly sound were wiped out by the catastrophic decline between 1929 and 1933. The Federal Reserve System has been able to save most banks whose condition was sound.

The inelasticity of credit which characterized the National Banking System was largely corrected by the same changes that made the note issue elastic. The Federal Reserve banks, with their heavy cash reserves, are in a position to support the member banks in their advances of credit, if necessary. Member banks need not fear that they may be caught with perfectly good loans but inadequate cash, because they can secure cash by rediscounting their commercial paper at their Federal Reserve bank. Furthermore, the rigid requirements as to the amount of reserves carried by the member banks have been relaxed somewhat. Formerly banks were required to hold, but not use, a certain minimum of cash reserves. Under the Federal Reserve System, member banks may let their reserves fall below the legal minimum under certain circumstances, but they may not make new loans or pay any dividends until the reserves are brought back to the legal minimum. Finally, the Board of Governors of the system may raise or lower the reserve requirements, or suspend them for a month or more, assessing a tax on loans of member banks above the amount permitted by their legal reserves. Thus in various ways the Federal Reserve System has tried to make banking credit more elastic.

Centralization of bank reserves in the big privately owned banks of the central reserve cities has been completely eliminated by the requirement that all reserves of member banks must be kept in their respective Federal Reserve banks. These reserves are held there not as so much cash but in the form of deposits. The Federal Reserve banks thus become the custodians of the reserves of the entire National Banking System; and these reserves are no longer lent to stock market speculators but are held for the stabilization of the country's financial system.

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[10] Federal Reserve banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco; and they have branches in other cities.

Lack of central control can no longer be urged as a criticism of our banking system, for the Board of Governors, through its control over the Federal Reserve banks, exerts at least a measure of control over the system. Not only do the Federal Reserve banks assume some responsibility for the protection of sound banks caught in financial crises, but the Board of Governors tries to prevent unsound banking. At times it has also attempted to stabilze business conditions through (1) its function of rediscounting, (2) its control of reserves, (3) open-market operations, and (4) the regulation of credit practices of member banks, and "moral suasion" if regulation is impossible or inadvisable. The first three of these control methods will be examined briefly.

Rediscounting

As we have already seen, member banks have the privilege of taking their good commercial paper to their respective Federal Reserve Banks for rediscount when for any reason they want more cash. The commercial paper thus offered is *re*discounted at a specified rate, ordinarily somewhat lower than that at which the member banks lend to customers. When the rediscount rate is lower, banks can make a margin of profit by lending to customers at say 6 per cent, and offering the notes to their Federal Reserve Banks for rediscount at say 2 per cent or, very recently, even less. The theory is that in this rediscount rate the Board of Governors has a means of controlling the amount of credit extended by the banks. If the Board believes that the banks are extending credit too liberally, it can raise the rediscount rate and by thus reducing the profits in rediscounting induce the banks to curtail their lending; if, on the other hand it believes that business is too slack, that the banks are not lending freely enough, it can reduce the rate of rediscount and so encourage them to lend more. This is the theory on which the system was set up, but practically this means of control has not been very effective. It has been particularly ineffective in encouraging loans, for when banks cannot find borrowers they cannot make loans, whatever the rate of discount. As Keynes once said, "You can't make a man fat by lengthening his belt." In very recent years, including the war period, the banks have done little rediscounting, because they have little commercial paper that is eligible and because they can strengthen their reserve position more easily by selling government bonds or by borrowing from the Federal Reserve banks, using the bonds as collateral.

Regulation of reserves

Regulation of banking operations by changing the reserve requirements need not detain us long. The Board of Governors has the power to raise reserve requirements if it fears too great an expansion of credit, and to lower them if it wishes to encourage lending. Theoretically this should have some effect. If the banks are overextending credit, the Board should be able to force them to adopt a more cautious policy by raising the reserve requirements, particularly if at the same time it raises the rediscount rate to prevent the banks from resorting to the Federal Reserve banks. If the banks are not lending enough, the Board can provide an incentive for expanding loans by reducing reserve requirements, for this increases the amount of excess reserves—those above the legal requirement—which of course earn no interest for the banks. But if the banks cannot find borrowers at the interest rate they have been charging and if they are not willing to reduce it, the incentive may not operate to change the amount of lending to any extent.

Open-market operations

Open-market operations represent a third device used to stabilize business conditions. Although the Federal Reserve banks are bankers' banks set up to guard and control the member banks, they may themselves engage in the purchase and sale of commercial paper, government bonds, and bills of exchange, just as private banks do; and through such open-market operations, carried on through the Federal Open-Market Committee, they may exert some influence on the amount of bank loans and the course of business. If the Board of Governors believes that bank loans should be expanded, it may, under the direction of the Federal Open-Market Committee, instruct the Federal Reserve banks to go into the financial market and buy commercial paper and bonds—the latter almost exclusively in recent years. The money paid out for these bonds will be deposited in the banks by the recipients and will increase the banks' supply of funds. With increased funds, the banks are likely to pay off their indebtedness to the Federal Reserve banks, or, much more likely, build up their reserves at these banks. In either case they will be able to lend more to customers than before and will have an incentive to do so, for excess reserves earn nothing.

If, on the other hand, the Board of Governors believes that the member banks are being too generous with their loans and that there is danger of generating an unhealthy boom, the Federal Open-Market Committee may call for the sale of commercial paper or bonds held by the Federal Reserve banks. Purchasers of these draw checks payable to the Federal Reserve banks against their deposits in member banks, thus reducing the member banks' deposits with the Federal Reserve banks, drawing down their reserves, and so reducing their capacity to extend credit to customers.

The idea that the Federal Reserve System should try to stabilize the price level and business conditions has grown up largely since the First World War, especially since the onset of the depression in 1929. It has not yet been very successful, and there is ground for pessimism as to the possibility of stabilizing business; but so disastrous have been the effects of some of our business recessions, particularly the depression of 1929 to 1939, that the government will undoubtedly persist in its efforts to find some form of regulator.

Insurance of bank deposits

The Federal Reserve System has been altered in many respects since it was first established and it is being further modified from time to time. Among the most important recent changes is the establishment of a system of federal insurance of bank deposits. During the decade from 1923 through 1932, 9883 banks failed, with deposits of 4 billion dollars; 4000 more failed in 1933. Forced to act by this succession of disasters, Congress passed a law setting up the Federal Deposit Insurance Corporation, with funds from the government and from the banks, to insure depositors up to $5000 of their deposits.

Guaranty of bank deposits has always been opposed by bankers on the ground that it would encourage careless banking and penalize the sound, conservatively managed banks by throwing on them the burden of reimbursing depositors of the badly managed banks that fail. This argument seems sound, but of course it does not help the depositors who lose through bank failures, nor are they in a position to know which banks are well managed and which are not. Another argument against guaranty is the fact that it has been tried in a number of states and has always failed; but the answer often given here is that the states did not regulate the banks carefully enough, that if when they guaranteed deposits they had also tightened up their bank regulations and examinations they could have prevented most of the failures. This the federal government has done, and some competent authorities believe that there is little reason to fear disastrous losses from bank failures in the future. At any rate, it seems likely that the federal government will adhere to its guaranty policy, for such losses as depositors suffered during the Great Depression were on the point of completely undermining the people's confidence in banks. The people will demand security for their savings, and the government must in some way provide that security.

Guaranty of deposits does not get down to the fundamental need for sound banking, and banking practices in the United States have on the whole not been on a very high level; many bankers have been incompetent and some have been worse than that. Various investigations of the banking business during the last decade or so have revealed startlingly low standards of ethics in certain high banking circles—close connection with speculative undertakings, encouragement of employee speculation in bank stocks, loans to directors (in some cases never repaid), bonuses to officers, nepotism, and a few cases of downright skullduggery. As a result of such revelations the president of one large New York bank was sent to the penitentiary, another one missed it by a hair, and some others lost all their standing as bankers. Where such a situation exists, neither guaranty of bank deposits nor any other form of government regulation can make banking serve the public needs effectively.

Government banks

Largely as the result of the depression, the federal government has recently invaded the field of credit and banking. The Postal Savings System had been established in 1910 to provide for the safekeeping of small savings accounts, at the modest interest rate of 2 per cent. Most of the present federal banking activities, however, are in the field of farm and home financing, where some federal loans were made as early as 1916, after years of agitation for better credit facilities for farmers, for whose needs the private credit agencies did not provide adequately. Mortgages were commonly written for five years, and in some cases only three; but to clear a mortgage of any size, most farmers needed ten to twenty years or even longer. Likewise their need for intermediate credit was not well met by commercial banks. Such banks could not deal to any extent in loans running for more than six months, whereas intermediate credit was usually needed for from six months to three years; furthermore, the interest rates were generally too high. To meet the mortgage credit needs of farmers, Congress passed the Federal Farm Loan Act in 1916, which, with later amendments, set up twelve Federal Land banks, one for each of twelve districts, after the pattern of the Federal Reserve System. Under President Franklin Roosevelt a number of kinds of lending agencies were established, some but not all of them federally operated, the others private or cooperative and operating with federal aid. Several other agencies have also been established to help finance urban homes, to bolster up mortgage debts already outstanding, and to stimulate building and provide jobs for the unemployed. There is no systematic, consistent plan in all these agencies, but perhaps they will some day be better coordinated.

The general trend now, as for the past century, is toward more government participation in banking functions; and there is no reason to anticipate a reversal of it. Whether the government will some day take over the entire banking system, as the socialists demand, is a question that we need not discuss here. The general temper of the people is so strongly opposed to socialism that our effort should be to make our present system work better, rather than to try to shift to another system.

QUESTIONS

1. Discuss the wide prevalence of debt in modern society.
2. In what ways may credit be classified? Why is consumers' credit generally viewed with hostility by bankers? Why have they nevertheless entered this field to some extent in recent years?
3. Consumers' credit is often said to speed up the purchase of goods, and therefore production. Show why this is a false notion. Why does the extensive use of consumers' credit make our economy more unstable? What effect does it have on prices?
4. In what important respect does a loan made by a bank differ from one made by an individual lender?
5. Explain how the goldsmiths developed the essential functions of banking.
6. Describe briefly the business done by each of the different kinds of banks. Which of them "manufacture credit"?
7. What is a bank reserve? What is its object? Before the establishment of the Federal Reserve System, what reserves did a bank need to be perfectly safe against a run?
8. Before the Federal Reserve System was established, every bank was "potentially insolvent." Why?
9. What were the important defects in the National Banking System? Indicate how the Federal Reserve System was designed to correct each of these defects.

10. Explain how the Federal Reserve System was designed to control bank loan policies through its function of rediscounting for member banks. How effective has it been in this?
11. Explain the money function of banks. How are checks cleared when they are drawn in favor of someone in a distant part of the country? What justification is there for the bank's charge for clearing checks?
12. How does the use of deposit money tend to increase the instability of the economic system? Should we deprive the banks of their power to create and destroy money in this way?
13. Why were commercial banks investing more and more in government bonds, even before the outbreak of the Second World War? Did they prefer government bonds that yielded 2 per cent to commercial loans that yielded 6 per cent?
14. The government borrowed much of the money to finance the war from private banks. Why did it not borrow from the Federal Reserve banks and save the interest charge? Why did it not print paper money to pay for war materials? Would paper money be more inflationary in its effect than bank money (in the form of deposits)? What would happen to the paper money after it had been paid out?
15. Explain open-market operations. How effective have they been?
16. Suppose a very ingenious and enterprising thief stole the gold stored at Fort Knox and substituted gilded lead bricks; what difference would it make in our monetary situation as long as the theft was not discovered?
17. What agencies are there to care for long-term savings?
18. Why has the business of the investment banks declined in recent years?
19. What have been some of the evil practices of investment trusts?
20. What is the most serious fault in the life insurance business? What remedy can you think of for this?

Chapter 21.

Price Levels

Among the most important causes of economic distress throughout modern history have been the fluctuations in price levels. The long declines following the Napoleonic Wars, the Civil War, and the First World War marked periods of generally poor business and economic distress; and the rapidly rising prices of wartime have caused troubles of a different kind and for different classes of people. Furthermore, with the growing complexity and integration of our economic system and the increasing prevalence of debt, the evils resulting from fluctuating price levels have been increasing. So serious were the results of the price decline in the period from 1929 to 1932 that some economists began to doubt whether the capitalist system could endure long unless such fluctuations could by some means be brought under control.

By price level the economist means an *average* of prices. Although there is no official computation of *all* prices, the United States Bureau of Labor Statistics includes wholesale prices of nearly a thousand commodities in its computations. In estimating changes in the price level, all prices must be reduced to percentages of the prices prevailing in the year that is taken as a base. Prices of commodities do not all change equally, of course, or in the same direction; but when we say that the price level has risen 35 per cent since 1939, we mean that the average rise in the prices of the commodities included in the computation has been 35 per cent. There are various ways of computing this average rise, but we need not consider them here.

Effects of changing price levels: falling prices

Changing price levels have their greatest effect in debtor-creditor relationships. A declining price level means a rising value of money. For example, a decline of 50 per cent in the price level means a rise of 100 per cent in the value of money; in other words, at the end of such a decline, a dollar will buy twice as much as at the beginning. During such a decline debtors find their debts growing heavier; they must pay a fixed number of increasingly valuable dollars, the equivalent of increasing amounts of goods, to clean up their debts and as interest on debts. This is what was happening in such periods as 1866 to 1896 and 1920 to 1932. During the latter period the price level fell more than 50 per cent, which meant that debts contracted in 1920 and paid in 1932 were paid more than twice over, in terms of commodities. For some debtors the real burden of debt increased even more than this. A wheat farmer who put a $1000 mortgage on his farm in 1920 when wheat was worth $2.50 a bushel might have paid it with 400 bushels of wheat at that time; but by 1932 the price of wheat had fallen to about 25 cents, and it would therefore have taken 4000 bushels of wheat, ten times as many, to clear the mortgage. Thousands of farmers were caught in this situation, and a very large proportion of them lost their farms.

Other debtors suffer similarly from declining prices—businessmen who have incurred debts in times of prosperity, and many business corporations. The debts of corporations are largely in the form of bonds whose weight, like that of other obligations expressed in dollars, bears more heavily as the value of the dollar rises. Most of the railroads of the United States have large amounts of bonds outstanding, and in every serious price decline some of them find that it takes all their net revenues to pay the interest on these bonds, while others cannot meet even this fixed interest charge and are forced into receivership, the stockholders losing all or most of their investment. Because times of falling prices are usually also periods of business stagnation, bonds are a burdensome part of a corporation's capitalization.

A considerable drop in prices may transfer to creditors all the equity that debtors hold in their property. Most of the farms mortgaged in 1920 were mortgaged for only about half their current value, but when farm values declined 50 per cent, the creditors took the farms. The debtors lost their half of the land value, and the creditors got the farms for half price, because the value of their money had doubled. Similarly, bondholders in some business concerns were able to take over these concerns, although the money originally invested in the bonds represented only half the value of the properties. This sort of thing happened throughout the business world, many billion dollars' worth of property being transferred from debtors to creditors. The total value of the property thus transferred cannot be stated, but it was probably at least 50 billion dollars. There were about 250 billion dollars of debts in the United States in 1929—federal, state, county, municipal, corporate, and private—equal to more than half the wealth of the country. By 1932 the price level had declined more than 40 per cent, which meant that the value of the dollar, and the burden of these debts, increased 66 per cent. If there had been no deductions, no losses on these debts, 165 billions of wealth (measured in terms of the 1929 price level), or more than one-third of the nation's wealth, would have been transferred from debtors to creditors in about three years. There were certain duplications, balances, and deductions, however, so that the amount was not as large as this; but it could hardly have been less than 50 billions. This wealth was usually transferred, be it noted, from people who had earned it to others who had not earned it at all.

Still other classes lose in a decline in the price level. Businessmen, except money lenders, generally lose. Manufacturers lose, not only because of the slack demand for goods but because they must buy their raw materials and hire their labor at one price level, and sell their goods, perhaps nine months or a year later, at a lower price level. Wholesalers and merchants generally lose by a decline in sales and by a decline in the value of their stocks of goods while they hold them. Farmers lose not only as debtors but as farm producers, through the decline in the price level between the time when they plant their crops and the time when they sell them; or, if they are raising livestock, they may lose even more, because they may feed their stock for several years and then sell it at a lower price level. Thousands of livestock producers were ruined in the price decline of 1920 and 1921.

Other classes also may lose. Buyers on installment credit are debtors, and like all debtors they generally lose; for as prices decline they pay their installments in more and more valuable money, and if they complete the payments what they have bought has probably declined in value while they were paying for it. Where the term of payments runs only for a year or so, this may not be very serious; but where it runs for ten years, as in the case of many building and loan payments on homes, buyers often find it necessary to stop payments, perhaps with the loss of all they have paid.

Although life insurance is a form of installment purchase, it presents a different case. As the price level declines, policyholders must make their payments in more and more valuable money; and those who are unable to keep up these payments must surrender their policies, perhaps at some loss in terms of dollars. Yet if they surrender their policies for the cash surrender value, this value will be in terms of the now more valuable money and they may lose little or perhaps nothing. If they can manage to pay the premiums, and if the price level continues to decline until the policy matures, they will gain because the payment at maturity will be in money which is worth more than the money they paid in premiums. Life insurance is generally a good investment in a period of declining prices, if the insuring company is strong enough to survive the decline and if the insured is able to keep up his payments.

Finally, when political units—counties, cities, states, and nations—are in debt, the taxpayers as a class lose through declining prices, because as prices fall the taxpayers must pay the taxes to cover the debt interest and principal in more and more valuable money, which is the equivalent of higher and higher taxes. This has been the situation after practically every war in our history. In 1920, for instance, after the close of the First World War, the federal debt was about 25 billion dollars. Within a little more than a year the price level fell precipitously nearly 40 per cent, with the practical result of adding 66 per cent to the burden of this debt. Somewhat like debts, the salaries of public officials and government employees are not changed readily, and hence for several years they may represent an increasingly burdensome fixed expense to the government.

Who gains from a fall in prices? It might appear that the gains should equal the losses; but this is not true, because when prices decline, business is likely to be slow, production is low, and there is a general net loss in the real income of society. The gains are likely to be less than the losses; yet certain classes do gain. In general, the owners of money or of instruments calling for the payment of money—bonds, mortgages, bank accounts, and accounts receivable—are the gainers. In the modern world not many people hoard money, but in periods of financial jitters a few do, perhaps keeping it in a strong box or hiding it away somewhere, and they gain to the extent of the rise in its value. The owners of money in 1920 and 1921, when prices declined nearly 40 per cent, enjoyed an increase of 66 per cent in the value of their money. Most savers put their money in the bank in the form of a deposit account or in bonds or mortgages, and they gain similarly. As we have seen, bondholders also gain. The owners of sound bonds more than doubled their wealth between 1920 and 1932, just from the increase in the value of money. Even in the short period from 1929 to 1932, when the price level declined about 42 per cent, bondholders received an unearned increment of almost 70 per cent on their investment.

Among the conspicuous beneficiaries of falling prices are endowed institutions, such as hospitals, research foundations, colleges, and universities, if their investments are in good sound bonds. Some of the great universities have endowments running up to 150 millions or more, and in the price decline of 1929 to 1932 those which had invested conservatively were in a position of affluence. Others that had a considerable proportion of "lemons" among their investments suffered accordingly.

Since a falling price level wrecks many weaker business concerns, particularly those in debt, stronger concerns may gain, in the long run, by taking over a larger share of the business, even though they lose immediately. Weak banks are likely to fail in times of falling prices, but strong banks often take over farms and business firms that owe them money in such a period, and finally emerge with greater resources than ever. This is to some extent the process by which strong banks tend to increase their wealth and power over business. Laborers who are able to keep their jobs also gain during price declines, particularly if they are well organized, because their wages usually fall more slowly than prices; but of course those who are thrown out of their jobs suffer greatly. It is more than doubtful whether laborers in general gain from falling prices. Certain classes gain, teachers and government employees particularly, because salaries are usually reduced more slowly than prices drop. Contractors are somewhat like laborers, in that if they can keep busy during a price decline they may gain, because they take contracts at one price level and buy their materials and labor somewhat later at a lower price level; but the amount of work contracted in such times is likely to be small, so contractors usually lose.

Rising prices

A period of rising prices brings the reversal of all this. Most important, of course, is the gain to debtors through the decline in the value of the dollar in which their debts are expressed. In the period of rising prices which began in 1896, many farmers were able to pay off their debts with ease; and they gained in other ways, particularly through the rising price of their land. Farmers have a heavy investment in their farms, relative to the size of their incomes; and changes in the price level, to the extent that they extend to land prices, are likely to affect them greatly. Other people gain too—

farmers as producers, and merchants and most businessmen. Stockholders not only may gain through the brisk business characteristic of such a period, and the fact that manufacturing concerns buy their materials and labor at one price level and sell their products later at a higher level; but if their company has any bonded indebtedness, they gain, like other debtors, through the declining burden of this bonded debt. Taxpayers in general gain through the decreasing burden of public debts and the fact that many public expenses, such as the salaries of teachers and other government employees, do not rise as fast as the price level.

On the other hand, many other classes suffer as prices rise: money hoarders, bond and mortgage holders, life insurance policyholders whose policies mature when prices are high, salaried men and women (because salaries rise less rapidly than prices), laborers, contractors, and public utilities. Public utilities generally lose, or perhaps we should say that they do not fare as well as they do with stable or declining prices, because their expenses rise and they may not be able to secure corresponding increases in rates promptly. If people could know what is happening during a period of rising prices, many of them would not be happy, for they are piling up debts and getting into the worst possible position for the spill which is at the end of the incline, for the reversal that surely lies ahead.

From the above discussion it appears that a stable price level is greatly to be desired, that any deviation from stability brings distress and injustice to certain classes of people. A moderate rise in the price level is not altogether bad, however, in its immediate effects. Apparently the economic system works better on a slightly rising than on an unchanging price level, the slight increase acting as a stimulant to business activity. One of the most prosperous eras in our history was the period from 1896 to 1914, when the price level was rising at a rate of about 3 per cent annually. A gradual price increase does impose some loss on creditors, but creditors are generally people of sufficient resources to stand a small loss without great suffering; furthermore, in such a period the nominal rates of interest (the rates quoted without allowance for the depreciation in the value of money) are sometimes high enough to make up, to some extent, for the declining value of money. A much more serious difficulty is the fact that such a ground swell of prices cannot last indefinitely, for it creates maladjustments within the economy that inevitably bring depression and a recession in prices.

Interaction of economic factors

The student must not assume that all the distress that accompanies rapid price fluctuations is the direct result of those fluctuations, that the price changes *cause* all the evils with which they are associated. In a sense they do cause these evils; but fluctuating price levels, characteristic of the cycles of prosperity and depression, are themselves the *results* of other conditions that develop in business cycles. For instance, falling prices may help to cause bank and business failures; but bank and business failures in turn have their effect on prices. The case is not one of simple cause and effect, but of interacting cause and effect.

Perhaps this will seem an overlong discussion of shifting price levels, but the importance of the problem justifies a fairly full discussion. Changing price levels have been responsible for the making and losing of fortunes, the transfer of billions of dollars of wealth from one class to another, the loss of the homes and savings of millions of helpless people and the vast unearned gains of others, and injustice and hardship that would be hard to picture. Hence it is not surprising that the government is making every effort to discover how to keep price changes under control.

The price level a problem in price determination

Coming now to the consideration of the forces determining the price level, we face one of the most controversial questions in economics. Broadly speaking, we may say that this is another illustration of the law of demand and supply, but one that works in a manner the reverse of that studied in earlier chapters on price. The price level represents the *value of money* in reverse. When prices are high, the value of money—in terms of commodities exchanged for it—is low; and when prices are low, the value of money is high. The determination of the price level thus becomes a problem of determining the value of money; and the value of money, like the value of anything else, is determined by demand and supply, the demand being represented by all the commodities or services offered in exchange for money. An increase in the number of commodities offered in exchange for money will tend to raise the value of money, will lower the price level; and an increase in the supply of money will tend to lower the value of money, will raise the price level. Most students will find it difficult to follow this reasoning because here money is on the *supply* side of the equation, whereas in most value or price analysis, *commodities* are the supply, and money is the medium through which the demand is expressed; yet this analysis is fundamentally correct. Our analysis, although essentially the same, will be more easily understood if we put it in the form of the Quantity Theory of Money:

$$\frac{MV + M'V'}{T} = P$$

In this equation M, money, includes cash of all kinds actually circulating as money—gold, silver and paper—but not hoarded or "sterilized" money, as for instance the gold in the vaults at Fort Knox. It does not include cash reserves held by banks, or the gold and silver held against gold and silver certificates or other forms of paper money, for this gold and silver do not circulate as money.

V is the velocity of the circulation of money, the number of times it is used in a given period in the purchase of goods. If people keep little money on hand but spend it quickly when they receive it, its velocity will be high; but if they keep considerable amounts on hand, delay spending what they have, its velocity will be low. Doubling the velocity of money—doubling the number of transactions it effects—would have the same effect on the price level as doubling the amount of money. The velocity of money depends on a great many factors which can only be mentioned here. It is affected by the stage of development of the financial system of the community or country, being low in those which lack well-developed banks and other financial institutions. It was generally low in medieval times and in pioneer communities in the United States, and it is lower in France than in the United States today. The velocity of money is likely to be low in communities in which money payments are made at long intervals, because the people are likely to hold their money longer. It tends to be lower where money receipts are irregular than where they are regular, for people will be impelled to keep more money on hand when they are not certain how soon they will get more. For this reason, the velocity is likely to be higher in a labor community where men are paid every week than in a farm community where much of the income is received in a certain season and must last until the same season next year. Finally, the velocity is likely to be greater in times of optimism than in depressions. People are inclined to spend freely in times of optimism and rising prices, partly because they see prices going up and partly because they feel confident that they will get more money presently; but this is reversed during business depressions.

M' indicates bank demand deposits, which represent purchasing power as truly as cash, so definitely so that they might have been included in M. The amount of bank deposits, which arise largely from loans, depends on a great many factors, most of which we have already considered. In the first place, it depends on the percentage of reserves required by bank laws. In the second place, it depends on the conservatism or recklessness of bankers, and, in the third place, on the general efficiency of the banking system. The creation of the Federal Reserve banks, which hold heavy reserves ready to aid banks in distress, greatly reduced the size of the reserves needed by banks and increased the amount of deposits that they could safely create. In the fourth place, as we have already noted, the amount of deposits depends to some extent on the willingness of businessmen to borrow, and this depends on business confidence, on the opportunities for investment, which in turn depends on a vast number of factors that cannot be discussed here. During World War II, the deposits depended largely on the amount of loans to the government.

V', the velocity of bank deposits, depends on somewhat the same factors that determine V: the general habits of the people with respect to spending and hoarding, the efficiency of the banking mechanism, the frequency and regularity of money receipts, and the optimism of the business community.

T represents "the physical volume of goods, services and securities sold for money in a given area during a specified period of time," and includes everything that is sold for money, counted every time it is sold.[1] Here is the demand for money, in our upside-down demand and supply theory of the value of money which is the reverse of the price level. The greater the quantity of things bought with a given flow of money, the lower will be the price level; and the smaller the quantity of things bought with a given flow of money, the higher will be the price level. Obviously a vast multiplicity of factors affects the volume of goods. The general physical productivity of the country is of course a constant factor, itself determined by the size, health, energy, and intelligence of the people, the business energy of its entrepreneurs, the knowledge of its scientists and technicians, the richness of its natural resources, and the supply of capital equipment. The volume of goods bought is also affected by the extent to which production is specialized, because specialization generally increases both production and the average number of times that each good is sold. When, for instance, the housewife clipped the wool from the sheep on the farm, spun it into yarn, and knitted the yarn into socks for her family, goods were produced, but no money was used in any of the transactions. When the business became specialized—one man raising the sheep, another spinning the wool into yarn in a factory, another making the yarn into socks, a wholesaler, a retailer, and a consumer in turn buying the socks—money was used at each step. Integration of industry, on the other hand, tends to reduce the demand for money, and so to reduce its value and raise the price level. When a single integrated company produces crude oil, refines it, transports it, and sells it to the consumer, no money is likely to be used in transferring the product from one branch of the company to the other, whereas if the producing, refining, transporting, and selling were done by separate concerns, each transfer of the product would call for the use of money.

The physical volume of goods is affected by certain other factors which vary considerably from time to time, perhaps with the amount of business activity. The amount of unemployment, of labor and of capital, of course affects the volume of goods sold, as does also the amount of new security issues and the number of times they are sold, and the extent to which goods are bartered.[2]

P is the level of prices established by our equation. It has already been defined.

Validity of the price equation

This is our price equation then. In brief it means that the amount of purchasing power $(MV + M'V')$, divided by the number of things purchased (T), equals the price at which they are purchased. Stated thus, it is so obviously true as to be a truism. It is like saying that $\frac{12}{3} = 4$. The difficulty emerges when we try to evaluate the factors and to figure out all the complex interactions among the six factors, M, V, M', V', T, and P.

The naïve Quantity Theory of Money

In a simple and naïve interpretation of the Quantity Theory, money (M) is assumed to be the important factor, the star in the drama; changes in the price level are assumed to result mainly from changes in the amount of money. Credit (M') is assumed to change proportionately with the change in money, because the banks normally carry a certain percentage of reserves against deposits, and changes in the supply of money will bring proportional changes in the amount of deposits. While transitionally, in the shift from one price level to another, the velocities of money and credit will change, they will tend presently to return to their former level; and of course any changes in the volume of trade (T) are assumed to affect the price level. The amount of money is the important factor, the causal factor, according to this theory.

This naïve theory was best formulated by Irving Fisher, and with some qualifications it was at one time accepted by many economists. In its simplest form, with almost the entire emphasis on money, it was held by George F. Warren, who was one of President Franklin D. Roosevelt's advisers on monetary policies. Warren believed that fluctuations in the price level were largely due to changes in the supply of gold. For long swings in prices, such as the price increases from 1848 to 1860 and from 1896 to 1914, and the price decline from 1873 to 1896, most economists concede that the money (gold) supply had a great influence, although money was only one factor in these changes. The amount of gold money was actually increasing between 1873 and 1890, but the volume of trade was increasing even more rapidly with the rapid growth in the country's population and wealth, and the result was a decline in the level of prices. Perhaps most economists would agree with Fisher's theory that in "normal periods," that is, when there is a long enough time for the factors to exert their full influence, money is fundamentally important; but there is evidence that the effect of an increase in the supply of money may not become apparent for several years. For example, gold production began to increase rapidly in 1891, but the price level continued to fall for five years afterward, until 1896. From 1896 to 1914 prices rose steadily, as we can see in Fig. 37.

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[1] Lester A. Chandler, *An Introduction to Monetary Theory*, p. 41.

[2] One of the best discussions of the Quantity Theory is to be found in Chandler's book just cited. His analysis is being followed to some extent in the present chapter.

The naïve Quantity Theory of Money does not take into consideration all the complexities of the problem, however, particularly for short periods and rapid fluctuations. An increased amount of money might not all go into circulation if the people were uncertain or frightened as to the outlook; and as reserves in the banks the money might not result in an expansion of deposits if the banks were fearful of lending or if businessmen did not wish to borrow. Such a situation existed generally from 1930 to 1940. Changes in the amount of money might not provide the initial impetus for a change in prices; this might come rather from a revival of business confidence and an expansion in credit. There is always a tendency for the factors to reach some kind of equilibrium, with interactions of cause and effect, but this tendency is never fully realized because new forces enter into the situation before a stable equilibrium can be reached. An increase in money, if it initiates a rise in prices, is likely to increase the velocity of the circulation of money and the amount and velocity of credit, all of which tend to raise prices further; but on the other hand all this is likely to increase the volume of trade, which will tend to retard the rise in prices.

A price rise, instead of being merely a pas-

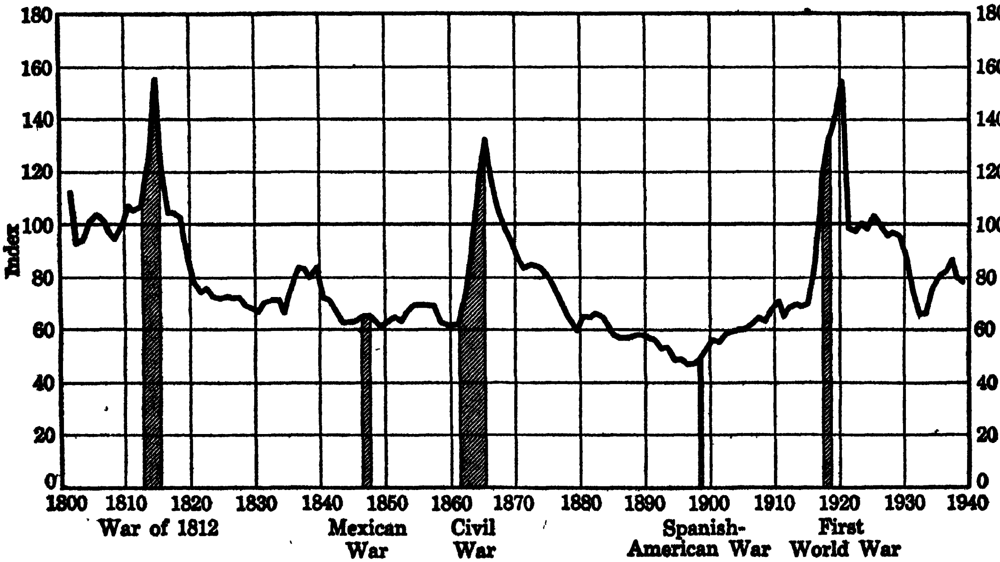

FIG. 37. Wholesale Prices, All Commodities, Yearly Average. (1926 = 100.) (From Temporary National Economic Committee, *Hearings*, Part 21, p. 11023.)

sive element, the result of the action of the other factors, may itself be a causal factor that acts on the others. If the rise is believed to be only temporary, it may bring a reduction in buying, and so in production and volume of trade; but if it is thought likely to continue for a long time, it may further increase the volume of trade, since people will presently begin to buy speculatively, and it will also tend to increase the velocity of money and the amount and velocity of credit. Finally, a long-continued and considerable rise in prices is likely to have an influence on the amount of money in a country that is on the gold standard. As prices rise—as the value of the dollar falls—gold mining becomes less profitable, and so a long-continued price rise tends to reduce gold production and to slow down the increase in the stock of gold money, thus retarding or perhaps stopping the rise in prices. This happened in the later years of the First World War and continued until 1920; the reverse of this was seen during the Great Depression when prices fell so low—when the value of gold rose so high—that gold mining became profitable again and gold production staged a spectacular comeback.

For short-run fluctuations in the price level, particularly those related to the business cycle, most monetary authorities do not regard the naïve Quantity Theory of Money as very significant. They tend to give more emphasis to such factors as business confidence, bank loans and deposits, savings and investment. Careful discussion of these will be reserved for the next chapter. For the present it will suffice to say that when businessmen have confidence in the business outlook they borrow freely to expand operations or to engage in new enterprises, and this borrowing involves the creation of bank deposits and leads to a rise in prices; but when they lack confidence, they try to reduce loans—or the banks insist on this—thus reducing the amount of deposit money and depressing the price level.

Relation of savings to investment

The relation of savings to investment has been heavily emphasized in many recent discussions of the price level. As either cash or bank deposits, savings tend to withdraw money from circulation. Savings in cash are subtracted from the amount of money in circulation; if deposited in the bank they tend to build up idle reserves; and if used to pay debts they reduce the amount of bank deposits and so reduce prices. Investment, on the other hand, puts money into circulation. When a businessman builds a new plant or buys new equipment or machinery or expands his operations in any way, he puts money, cash or deposit money, into circulation through the purchase of labor and materials. If savings and investment are equal, the amount of money and bank deposits should not change, and prices should likewise remain unchanged; if savings exceed investment, the amount of money in circulation, including bank deposits, declines and prices fall; and if investment exceeds savings, the excess investment being financed through bank loans, bank deposits increase and prices rise.

Schemes for controlling the price level

People have never borne the distress and injustice caused by changes in the price level without complaining and urging remedies. In the long slide from 1873 to 1896, bimetallism was the remedy most commonly advocated; in the persistent rise from 1896 to 1920, Fisher's "compensated dollar" was the most widely discussed remedy; and in the price recessions of 1920 to 1921 and 1929 to 1933, the compensated dollar and a wide variety of other proposals were urged and debated up and down the land. The compensated dollar has received so much attention that it merits some analysis, particularly since it was the basis of some of the monetary legislation of the New Deal.

The compensated dollar

The compensated dollar plan was a scheme for keeping the price level stable by regulating the number of dollars through varying the weight of the gold dollar. Thus if prices tended upward, the assumption would be that there were too many dollars; hence the weight of the dollars would be increased in order to reduce their number. If the price level started to decline, it would be assumed that there were too few dollars, and this would be corrected by reducing the weight and so increasing their number. Dollars of different sizes could not be circulated, for according to Gresham's Law the smaller would drive the larger out of circulation; they would not even be coined. The gold would be held as bullion in the Treasury, and against it would be issued certificates redeemable on demand in varying amounts of the metal. Actually it was a scheme for buying and selling gold at prices that varied with the price level.

It is evident that the plan for a compensated dollar is based on the naïve Quantity Theory of Money, and that it can be sound only so far as that theory is valid. To the extent that money is the important causal factor in price changes, altering the amount of it might be effective in a sufficiently long time. For such a long price increase as that of 1896 to 1914, perhaps a compensated dollar would be more or less effective. Changing the weight of the gold dollar would indeed alter the number of "bookkeeping dollars" in the country, but it would not change the number of dollars in the hands of buyers very quickly. As reserves in the banks, more dollars would increase the amount of credit that the banks could extend, but the amount that they actually would extend will depend on their willingness to lend and on their customers' inclination to borrow. A reduction in the number of dollars would force banks to restrict loans only if they had lent up to the limit set by their reserves; and in recent years few banks have been in that situation. The relation of money to bank credit is not as definite as the naïve quantity theorists have assumed.

Other objections to the compensated dollar can be considered only briefly. A constantly shifting dollar would be a serious difficulty in the setttlement of international obligations. Such settlements involve a calculation of the relative amount of gold in the moneys of different countries; and if the weight of our gold dollar were constantly shifting, it would inject an element of instability into foreign trade. Perhaps more important is the political difficulty of administering a compensated dollar scheme, for any commission entrusted with adjusting the weight of the dollar would be subjected to pressure from various economic groups. Furthermore, the compensated dollar could not have much effect on the hectic price declines during a crisis, for these declines are part of a general unsettling of values, reduction of bank loans, liquidation of debts, and loss of business confidence.

One of the arguments against the scheme is our own experience with it. When President Roosevelt took office in March, 1933, the country was in the depths of the worst depression in its history. Prices had been dropping precipitately from the levels of 1929, banks were failing by the hundreds and all were closed within a few days after the President entered the White House, debtors were being expropriated by the tens of thousands, and some fifteen million men were out of work. Sound money—the gold standard—had been maintained stubbornly while the country was sliding into this condition; and rather naturally there was a widespread belief that the monetary standard was at fault and an insistent demand that something be done to bring prices up again. Under these circumstances President Roosevelt happened to come under the influence of George F. Warren, a follower of Fisher and a firm believer in the naïve Quantity Theory of Money and the compensated dollar. The result was the adoption of something like Fisher's scheme in 1933 and 1934.

Under this plan the mint price of gold—the price at which the government bought gold—was raised from $20.67 to $35 per ounce, which meant that the size of the gold dollar was reduced from 23.22 grains of fine gold to 13.71 grains. This was assumed to increase the number of dollars in three ways. In the first place, it divided up the existing gold stock into smaller dollars; in the second place, the high mint price of gold, which amounted to an overvaluation of gold as compared with the mint prices of other countries, was sure to bring a heavy flow of gold from all over the world; and in the third place, this high price of gold was expected to revive the gold mining industry throughout the world, with a resulting increase in gold production and much of the world's gold flowing into the United States mint.

This monetary legislation should logically have raised the price level in this country; indeed, if we had remained on the gold standard and gold had been permitted to flow into the banks and swell their reserves, it might have caused a dangerous price inflation. It might have done this rather promptly too, because the reduction in the size of the gold dollar amounted to an *immediate* increase of several billions in the gold supply; but this was largely evaded by the policy of going off the gold standard and "sterilizing" much of the new gold in the vaults at Fort Knox. Prices did rise somewhat, but whether this was due to the gold policy or whether they would have risen anyhow cannot be answered with certainty. It is probable that this policy did have the effect of raising the price level to some extent.

War prices

During the Second World War, as in all big wars, the price level rose rather rapidly to a level, in 1944, 36 per cent above the 1935–1939 average, according to government estimates. Actually, it probably rose more than this, for the official figures were conservative. The government put billions of dollars into circulation, a large proportion of it borrowed from the banks. Bank deposits, largely created through loans to the government, rose from 46 billions in June, 1934, to 141 billions in December, 1944, most of this increase coming in the war years. In its purchase of war materials the government put out money at a tremendous rate, total money in circulation rising from 6.5 billions in January, 1938, to 26 billions in May, 1945. Along with this increase in money went a marked increase in the velocity of money and credit, while, on the other hand, the volume of goods for civilian use was steeply curtailed by the rapid conversion of industry to war production. How long the present inflationary situation will last is difficult to predict. If the experience after other great wars is to be repeated, we shall have perhaps a few years of high prices, or even rising prices, followed by a drastic deflation and a long period of declining prices and stagnant business; but the government will use every means at its disposal to prevent the price decline.

QUESTIONS

1. What classes gain in a period of rising prices? Why, in each case? What classes lose? Why, in each case? Do the losses and gains exactly balance in periods of rising prices and in periods of falling prices? Explain why or why not.
2. A slightly rising price level tends to stimulate business. Why?
3. "If all prices, and debts as well, declined equally in periods of rising or falling prices, price changes would not be a very serious evil." Do you agree? Are monopoly prices, which change little and tardily, a vicious influence in times of price changes? What is the effect of heavy debts?
4. Between 1873 and 1896, wholesale prices declined nearly 3 per cent annually. What was the actual rate of interest paid by a farmer on a 7 per cent mortgage?
5. The determination of the price level is an illustration of the law of demand and supply. Explain it in that light.
6. Arrange *MVTPV'M'* to state the Quantity Theory of Money. What factors determine each of these?
7. Which of the factors in the Quantity Theory of Money was largely responsible for the fall in the price level from 1873 to 1896, and for the rise from 1896 to 1914? What factor or factors operated to cause the drastic decline of 1929 to 1932?
8. Is the savings-investment theory of price changes consistent with the Quantity Theory of Money? Explain.
9. Why did the reduction in the size of the gold dollar fail to raise the price level very much? Manipulation of the gold dollar is calculated to affect only what kind of price fluctuations? Would it probably have had any marked effect on the price decline of 1929 to 1932, or on the rise in prices since 1939? Why or why not?
10. How effective are Federal Reserve bank policies likely to be in stabilizing the price level, such policies as changing rediscount rates or raising or lowering reserve requirements?
11. Suppose the government taxes heavily and pays off the federal debt to the banks rapidly; what will probably be the effect on the price level?
12. In the two years ending December 31, 1943, bank deposits throughout the country rose almost 41 per cent. What did those deposits represent? Did they have anything to do with the rise in prices during that period?

Chapter 22.

Business Cycles

In much of our discussion we assume an economic system which in general and in the long run tends to work in such fashion that nearly all labor is hired at prevailing wages, nearly all capital is employed in production, nearly all savings are invested in durable capital, and nearly all products of industry are bought at the prices set in the market. We also assume that there are forces tending toward stability, that the economic system works with reasonable steadiness. For some purposes all this is justifiable. The long-run tendencies are fundamentally important. In this chapter, however, we must consider the fluctuations, the economic St. Vitus's dance, the fever and ague, the recurrent ups and downs with which our economic system is perennially affected; and we must recognize that these cycles are not mere accidental phenomena, due to flaws in the system, but are natural and apparently inevitable in a capitalist economy. We are never in a normal or stable economic condition; we are usually moving up or down, from prosperity to depression or from depression to prosperity, a little like the rider on a scenic railway in an amusement park. Even when for a few years we seem to be enjoying stable prosperity or suffering chronic and stable depression, underlying forces are always changing in such a way as to bring different conditions.

Types of cycles

There are a number of different cyclical variations in business activity. Major cycles, the type with which we are mainly concerned, usually run from eight to ten years, although they may vary considerably in length. There have been some fifteen or sixteen such major cycles since 1812. In recent years, economists have outlined shorter fluctuations of three to five years' duration, two or three of these coming within the limits of a major cycle. These minor or interrecessional cycles ordinarily do not bring severe crises and business stagnation, and we shall not refer to them again. A few economists have asserted that there is evidence of cycles as long as fifty years or so. Spiethoff, for example, divides the span of almost a century, 1822 to 1913, into four periods: 1822–1842, a period of generally poor business conditions, including two business cycles in which the depression phases were longer than usual; 1843–1873, a period in which times were generally good, with several cycles in which the prosperity phases were unusually long and the depression phases unusually short; 1874–1894, a period of generally bad conditions, with depression predominating; and 1895–1913, a period of unusual prosperity generally, including two and a half cycles with only mild depressions. This period might well be extended from 1913 to 1920, because this was a period of war prosperity. Thus the history of about a century was marked by two long swings downward and two long swings upward; but the significance of these oscillations is not clear and we shall not consider them further. In this chapter we are concerned only with the major cycles of ten years, more or less.

Business cycles run through the successive phases of depression, revival, prosperity, crisis, recession, and depression in varying periods of time, with varying degrees of prosperity and depression, and with varying conditions as to price behavior, credit expansion and contraction, employment, and retail sales. No two cycles have been exactly alike; yet all show so many common traits that we can draw a general picture which will fit them all with fair accuracy; we shall do this before we take up the various theories as to the causes of cyclical fluctuations.

The depression phase

In beginning with the depression phase, we must for the present take the depression situation for granted, since we have not seen how it developed; that will be described later. We must content ourselves here with noting that in this phase there are many unemployed laborers and idle factories, with many of the industrial plants in need of repairs and replacements and below normal in their stocks of raw materials. Retailers who have not failed have allowed their stocks of merchandise to fall as low as they dare, as have also wholesalers; and retail sales are below normal, with much hand-to-mouth buying. A great many business concerns have been through the bankruptcy courts, and many debtors have either paid their debts or been closed out. There is some hoarded money, and banks have large cash reserves and a small amount of outstanding loans. Wages are generally low and interest rates are below normal; business profits have been and still are low, and the business atmosphere is pessimistic.

It is clear that we have here the conditions out of which revival may come, once the initial fillip is given. Inventories of retailers, wholesalers, and manufacturers being low, any increase in demand will bring increased buying and increased production; debts have been reduced; banks, with loans reduced and with large cash reserves, are in a position to extend credit freely when confidence reappears and businessmen want to borrow; wages and interest rates being low, production can be expanded at low cost. The "makin's" of a revival are here; but what gives the initial impetus to recovery is a disputed question.

The revival phase

The first step out may come from an increase in the expenditures of producers—manufacturers and industrial concerns—or of consumers. In some cases it is apparently the development of some new industry, the opening up of some new investment opportunity. Probably the rapid growth of the automobile industry had something to do with the revival from the depression of 1920 to 1921. Or, when the interest rate falls low enough, a few farsighted businessmen may see that it is a good time to make factory repairs or replacements or to resume operations in some line of business, and their expenditures may start the cycle of improvement. Perhaps the first blush of jocund morn may come from a revival of consumer spending, for some consumers will have been accumulating cash or bank balances during the depression, and they will begin buying when they think prices have reached bottom. Others, although probably not very many, will have completed payment of debts and will be able to buy more than before; and still others who have been hoarding money will decide to spend part of it. Sales of some kinds of goods, groceries for instance, do not decline very much in depression times; but sales of more durable consumers' goods, such as homes, house furnishings, and automobiles, may decline considerably because consumers can get along for some time without buying them. Eventually, however, if those who have funds believe that there is no probability of further price declines, they will begin buying again.

The prosperity phase

Whatever the exact nature of the force or forces that serve to start the revival, once it begins it tends to develop strength. An investment by producers, in either repairs, replacements, or new plant, will provide more employment for labor, more wages, which will increase the demand for consumers' goods; and this in turn will stimulate production of consumers' goods, with increased disbursements of wages, and in turn further increases in the demand for consumers' goods. This increase in the production and sale of consumers' goods may go on for a time without much increase in prices, because there is a large supply of unemployed labor which can be hired without raising wages. Manufacturers who have been producing at part capacity can expand to full capacity at no increase in costs, and in some cases at decreasing cost. The banks which called in loans during the early part of the depression now have heavy cash reserves which will enable them to advance credit on adequate security, and they will be anxious to do this, because idle reserves earn nothing.

For a time the revival may proceed in this way, with only a moderate rise in prices. Until most of the unemployed laborers are again employed and the demand for bank loans raises the rate of interest, the expansion of production is unlikely to bring a marked rise in the price level. When the most efficient laborers have been hired, however, and bank loans approach the limits set by available reserves, wages and interest tend to rise. In such a situation employers must hire less efficient laborers or bid against each other for the more capable workmen, thus raising wages; and the banks are likely to raise the rate of interest. But profits are still high. Producers hire their labor and buy their raw materials at one price level and sell their products later at a higher price level; consumer demand is strong, retailers and wholesalers are prospering, money is circulating rapidly, and optimism prevails.

During the period of prosperity, expansion is particularly rapid in the production of capital—new plant and equipment—and in durable goods generally, in accordance with the *principle of acceleration.* According to this principle, changes in the demand for finished goods bring more than proportionate changes in the demand for the capital used to produce those goods. For a simple explanation of this principle, let us assume that the value of the annual output of cotton sheeting is 100 million dollars, and that the cost of the capital equipment required to produce this is 500 millions, 10 per cent of which must be replaced every year, at a cost of 50 millions annually. Assuming full prosperity, with no idle plant and equipment, suppose that the demand for cotton sheeting rises 10 per cent, or 10 million dollars. This will call for the production of 50 million dollars' worth of new plant and equipment, which, added to the 50 millions in necessary replacement, will amount to 100 million dollars—a 100 per cent increase in the annual production of capital resulting from a 10 per cent increase in the demand for cotton sheeting. Something like this happens also in the case of such durable goods as homes and apartments and, less clearly, in accumulations of stocks of goods.

There are other reasons too, why, in the prosperity phase of the cycle, expenditures for capital equipment rise more rapidly than expenditures for consumers' goods. In the first place, expenditures for consumers' goods do not decline so much in the recession. Production of capital equipment may fall almost to zero in a time of deep depression. In the second place, investment in capital equipment will be made only in a period of strong business confidence, such as characterizes the prosperity phase. A man does not need great confidence to buy a suit of clothes, which will wear only a year or so at best, or even to buy an electric refrigerator, which, although it should last ten years or more, does not have to pay for itself commercially; but a businessman who invests funds, perhaps in part borrowed, in a factory which should stand for half a century and in equipment which should last at least ten years must have confidence that this equipment will repay its cost with interest. This confidence characterizes the prosperity phase of the cycle.

As the expansion gains momentum, speculation plays a more and more important part, with the result of further speeding up the business tempo. When prices have been rising for some time, businessmen come to anticipate further increases; merchants and wholesalers buy ahead of actual needs and accumulate large inventories of goods; manufacturers pile up heavy stocks of raw materials, and sometimes of finished goods; consumers buy freely, more and more of them resorting to installment credit. Not only commodities but stocks, land, homes, and business property are bought speculatively, in part on borrowed money, the stocks on margin, the real estate on mortgages; and as long as the prices of such things rise, speculator buyers feel that all's well with the world, and spend *their* money freely, and frequently borrowed money as well, thus giving added strength to the demand for consumers' goods and helping to raise prices.

In some types of speculation, conditions develop toward the end of the boom which make a recession inevitable, once the upswing is stopped. Speculators in stocks, farm land, and urban real estate bid up prices to a point higher than the current yields of such property justify, to a point where it is worth so much *only as long as it is rising in price*. The price represents to some extent a capitalization of future increases in price. At the peak of the boom in 1929, many stocks were selling at prices so high that they yielded only 2 per cent on their purchase price, which was about half the normal rate of interest. As long as the purchasers could expect a further appreciation of 2 per cent in the prices, they could count the stocks a good investment; but when their prices ceased to rise, they were immediately worth only half the prices at which they had been selling. Inevitably stock prices *begin to decline as soon as they stop rising*. Land speculation is not so closely tied to the business cycle as stock speculation, but at times it has had some influence, and the same situation develops. Here we see one of the reasons why a boom must always bring a recession.

Through the building of capital equipment, speculative purchases, and otherwise, during the prosperity phase, the amount of credit (debt) increases. Builders of new capital equipment may borrow from banks, or they may issue stocks or bonds and so secure their funds from the investing public. Many merchants and wholesalers borrow from the banks to enlarge their stocks. Speculators in stocks pay part of the purchase price of the stocks—much less than half, in most cycles of the past—and the rest is provided by the banks; speculators in land pay a part of the purchase price in cash, and the rest is provided, through mortgages, by the sellers; consumer buying is financed partly through installment credit provided by retailers, who in turn may rely on the banks. In various ways the amount of credit (debt) is expanded. Bank credit is expanded not only because of the increasing amounts of goods bought with credit, but also because of the higher prices at which those goods are bought.

Credit for expanding business comes largely from the banks; but this does not mean that the banks are "inflating" credit to the entire extent of their loans, for there is some saving during this phase of the cycle. If the total savings were equal to the amount of credit extended, there would be no inflationary tendencies; moreover, savings may be unusually large in the prosperity phase, since the amount saved depends largely on the size of incomes, and incomes are high. When the amount of credit extended is in excess of savings, however, the banks are presumably increasing purchasing power, with a consequent tendency to higher price levels. As the banks approach full extension of loans, interest rates also tend to rise.

Toward the end of the prosperity phase everything seems rosy. Businessmen are making profits; the banks, with heavy loans outstanding, are doing well; business failures are rare; most of the working people are employed at good wages; consumers are buying freely—"$50 down, and the rest in nominal payments"—debtors in general are cheerfully oblivious of their debts or even adding to them; speculators are piling up paper profits and dreaming of new sallies in Wall Street; farmers are prospering, buying more land, and signing new mortgages. Rosy optimism has replaced the indigo pessimism of the depression stage.

The crisis phase: the beginning of the recession

It is a beautiful world, in this last part of the prosperity phase; but it cannot last. Why? What is it that causes a reversal in the business trend? Here we cannot be certain of our answer, for the theories of the authorities are not in complete agreement, and the forces that turn prosperity to crisis and depression are not always the same; but a few general conclusions will receive the approval of most students of business cycles.

For one thing, it is clear that in the latter stage of the prosperity phase the economy has developed elements of weakness, of unsoundness, which make it increasingly vulnerable to shocks. The banks, with heavy loans outstanding, which means with relatively low reserves, are not in the strongest position to meet shocks to the banking system, such as a bank run. Since business has been profitable and business failures rare, it may be assumed that there are a considerable number of inefficient men in business. Debts are heavy, in the form of notes due banks and private money lenders, installment payments due, and mortgages and bonds. Wages and interest have risen to a point high enough to raise costs considerably and threaten business profits if the demand for goods declines. Merchants and wholesalers are likely to have large inventories, bought partly through credit; and much new plant and equipment has been built, some of which can earn a return only if the demand remains strong or in some cases actually continues to increase. The business structure is not in a condition to withstand a severe jolt easily.

The direct causes of the reversal in the business trend vary as given by different authorities. Without doubt, however, one reason for the shift is the fact that wages, which lag behind prices during the upturn, finally overtake prices and so cut the profits of businessmen. The rise in the interest rate has the same effect. A recession in some particular industry may throw men out of work, cut the demand for certain raw materials, and so reduce consumer demand and employment in other industries. A slump in the automobile industry played this role in 1920.

It is generally conceded that conditions in industries producing capital equipment have much to do with the downturn of business. During the depression phase, repairs, replacements, and improvements are likely to be neglected, but in the prosperity phase these are provided for, along with some new plant. We have already seen how an increase in the demand for finished goods may bring a disproportionate increase in the demand for capital goods, in accordance with the acceleration principle. We assumed a 100-million-dollar annual output of cotton sheeting, with capital equipment worth 500 millions, 10 per cent of which had to be replaced each year at a cost of 50 millions; and we saw how a 10 per cent increase in the demand for cotton sheeting would call for an addition of 50 millions to capital equipment, a 100 per cent increase in the amount of capital equipment needed. However, the production of 100 million dollars' worth of capital equipment can be maintained only if the demand for sheeting *continues to expand at this rate.* If the demand remained at 110 millions, no new equipment would be needed, and the annual repair and replacement expenditures would be only 55 millions—a drop of 45 millions. Even if the demand rose further but *less rapidly,* the capital equipment industry would suffer. Suppose, for instance, that the demand increased from 110 to 115 millions. This would call for the construction of 25 million dollars' worth of new plant, and this, added to the 55 millions needed for repairs and replacements, would amount to only 80 millions—a shrinkage of 20 millions. In short, the capital equipment industry can be maintained at its level of 100 million dollars a year only if the demand continues to rise at the same rate; a slowing down, even of the *increase* in demand, is enough to force curtailment of production.

The English economist Keynes finds an important cause of the reversal of the business trend in the capital goods industries, but his explanation is different. According to him, the reversal is due to a sudden fall in the "marginal efficiency of capital," coupled with a rising rate of interest. New investments in capital yielded a good return earlier in the prosperity phase. Some new industrial plants, hotels, and apartments were needed, but a point is reached where more of such capital investments yield a sharply declining return, where their "efficiency" declines rapidly, while of course the interest rate still tends to rise. In building up capital wealth, businessmen are guided by their *expectations* of future returns; and when the marginal efficiency of capital starts to decline, expectations as to future returns fall with it, and the production of capital goods is rather promptly abandoned, with resulting unemployment in these industries.

There are still other theories as to the cause of the reversal. A few writers find an explanation in the insufficiency of the demand for consumers' goods which are produced in mounting volume as new capital and equipment are added. This theory is sometimes coupled with the notion that economic inequality is the colored boy in the woodpile, that it is responsible for the fact that the masses of consumers cannot buy the full output. Other students of business cycles believe that spending tends to increase rapidly near the peak, and that the inadequacy of savings to finance the production of capital goods is an important reason for the reversal. Still other economists—Fisher, for example—point to the heavy indebtedness at the end of the prosperity phase as the important cause of the downturn.

Doubtless there is some validity to most of these theories. The initial jolt that brings the reversal may come in a variety of ways. It may come from restrictive action by the monetary authority, the Board of Governors of the Federal Reserve System. The Board may decide that a dangerous inflation is under way, and raise the discount rate in order to force the banks to stop expanding loans. If the banks have been borrowing from the Federal Reserve banks, this is likely to be effective, perhaps even to the point of inducing a *contraction* of loans. If the banks begin to contract their loans, they may well force liquidation of some enterprises, with widespread repercussions through the business world. Something like this happened in 1920, when our hectic postwar prosperity turned into the drastic deflation of 1920 and 1921. Or the first shock may come from the failure of a great bank, or of several of them. The failure of the Jay Cooke bank touched off the crisis of 1873, and bank runs on some New York trust companies ushered in the crisis of 1907.

The recession under way. A halt, or even a minor setback in prosperity, does not necessarily result in a depression. Sometimes the prosperity phase survives one or two such setbacks before it ends; but if conditions are ripe and the downturn once gets well under way, it is likely to continue through recession to depression. "The process of contraction," as Haberler says, "like the process of expansion, is cumulative and self-reinforcing. Once started, no matter how, there is a tendency for it to go on, even if the force by which it was provoked has in the meantime ceased to operate."[1] It is a cumulative process in various ways. Unemployment reduces wage payments and consumer purchases; reduced consumer purchases force reduced production of consumers' goods, which brings more unemployment; reduced consumer expenditures bring sharply and disproportionately reduced production of capital goods, which brings further reductions in employment and wage payments and in consumer expenditures; hoarding may appear, causing prices to decline and the business situation to grow worse, and this in turn may cause more hoarding; banks, anxious to get into a liquid position to meet possible runs or demands for cash, call in loans, forcing borrowers into bankruptcy and thus deepening the crisis and making greater demands on the banks, and forcing further credit restriction; some debt-burdened merchants, frightened by the shrinking demand and the decline in prices, or compelled by their creditors, throw their stocks of goods on the market at sacrifice prices, depressing prices still further and forcing other merchants to unload, thus sending prices down again; security prices decline, some margin speculators are obliged to unload their stocks on the market, forcing prices down further and bringing other speculators into the whirlpool of liquidation, with consequent further declines in quotations; a few banks fail, wiping out the savings of depositors, reducing the amount of credit, driving prices down, undermining the financial soundness of customers of other banks, and throwing other banks into insolvency; the falling spiral of business brings deepening pessimism, and the growing pessimism leads businessmen to reduce their operations still further. Thus in many ways the forces working for depression and deflation are cumulative, and after the recession has got under way it tends to gain momentum.

Conditions are unfavorable to business operations in the recession phase anyhow. As prices fall, costs tend to lag. Wage rates always decline less rapidly than prices, and interest rates are high during the early period of the recession. Businessmen can see little chance for profits; and even if they were optimistic they could secure little credit from the banks, which are calling in loans as fast as they can. Some prices decline much faster than others. Prices of farm products and raw materials tend to fall more rapidly than those of most manufactured goods, and prices of competitively produced goods fall more rapidly than those of monopoly-controlled goods. This dislocation in relative prices tends to reduce the amount of business done. In 1920, for instance, with wheat selling at $2.50 a bushel, farmers could well afford to buy farm machinery and other goods; but a year later the price of wheat had declined about 50 per cent, but prices of farm machinery had not declined appreciably. The result was that sales of farm machinery fell to a fraction of their 1920 level.

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[1] Gottfried Haberler, *Prosperity and Depression*, rev. ed., p. 323. This is one of the best treatises on business cycles now available.

The end of the recession. As with the prosperity phase, so with the recession phase, we may ask why does it not go on indefinitely? What stops this cumulative contraction of business? Here we can to some extent follow in reverse our analysis of the end of the expansion phase; and we begin by pointing out that conditions finally become such that the economy is less and less sensitive to unfavorable influences and more and more responsive to favorable influences. The elements of weakness, unsoundness, which developed toward the peak of the prosperity phase tend to be erased toward the end of the decline. Not in the earlier stage of the decline, be it noted, for in that stage the "disequilibrium" in the economic system may be quite as serious as in the hectic prosperity period; but in the later stage the economic system is in a stronger position than before. Many people are unemployed, but there is a limit to the spread of unemployment, for the industries that produce non-durable goods do not suffer greatly. Wages are down again, some of them to parity with the price level; and employed people, fearful of losing their jobs, work hard. "Hard times make hard work." These conditions favor the renewal of business operations, once businessmen feel more optimistic. Consumers, who have been skimping in their purchases, particularly of durable goods such as automobiles, are increasingly in need of new goods; and some of them have funds to buy with, when they come to the conclusion that a further decline in prices is unlikely, or that prices are likely to rise. Some who have been suffering the tortures of the damned in driving old cars will finally buy new ones if they can flush enough money to pay the first installment. Most manufacturers have been postponing repairs and replacements and are ready to enter the capital equipment market whenever conditions seem auspicious. Merchants are carrying light inventories, and many have cleared up their debts. Debts in general have been greatly reduced, through either payment or liquidation. Banks are in a strong position, with heavy reserves and reduced outstanding loans. Although they are very cautious in their loan policy after the stresses of the decline, they are anxious to expand loans if they can do so safely. Low interest rates offer an incentive for businessmen to expand operations whenever their pessimism changes to optimism.

Variations in cycles

So we return to the point whence we started; this is "where we came in." We cannot say how long the depression phase lasts, for it has varied widely in past experience. The depressions that began in 1873 and 1929, for instance, lasted six and eleven years respectively, but that of 1907 lasted less than two years. Cycles are not all alike. They do have certain characteristics in common, as outlined here; but every cycle is in some respects peculiar, and there is no definite period for the duration of any cycle, or of any phase of a cycle. This is one reason why it is usually impossible to predict the course of a cycle. A great many agencies offer predictions as to the course of business, but it is doubtful if any of them has a batting record better than 50–50, which means that they are generally about as good as crystal gazers. Indeed it is obvious that if the course of cycles could be predicted, there would be no more cycles; for whenever expansion rose above the mean of fair business conditions, businessmen would begin contracting, and whenever a recession fell below that mean, they would begin to expand. This does not mean that nothing is known about cycles, for a number of able economists are steadily enlarging our knowledge, and perhaps we shall some day know enough to bring business cycles under some sort of control. The amount of information regarding economic conditions at any given time—production, unfilled orders, sales, and the like—has been growing rapidly in recent years, and this may provide the basis for a more accurate analysis than has been possible in the past.

Various theories of business cycles

Having described the course of a typical business cycle, we now consider briefly some of the theories as to its cause and explanation. Since an almost infinite number of economic factors enter into the determination of cyclical conditions, the factors differing for every cycle, it is impossible to point to any single cause. Most authorities agree on certain common factors; but some emphasize one factor and some another, and so there are different theories of the business cycle.

Cycle theories may be classified in different ways. In the first place, they may emphasize causes which originate either *outside* the economic system—weather changes and resulting crop variations, wars or inventions—or *within* it—variations in production, demand, bank credit, and the like. An example of the first is Jevons's *sunspot theory*. This attributes cycles to the variations in sunspots, which are assumed to cause variations in weather and agricultural production. An example of the second is Wesley Mitchell's theory that cycles are *self-generating*, that each phase of the cycle inevitably generates the conditions which bring the next phase. Most economists hold to this theory, with emphasis on different factors, and the course of the cycle as we have described it follows it rather closely. Closely akin to this theory is Haberler's classification of causes into *exogenous* and *endogenous*, the former emphasizing external disturbances, the latter stressing forces at work within the economic system. This distinction cannot be drawn clearly, for almost all authorities would concede that weather, crops, wars, and important technological changes sometimes affect the course of business; and practically all of them would admit that endogenous factors are important. Most cycle students emphasize them almost exclusively. It is fairly clear that there is an inherent instability in the economic system, that it can work only in periodic spasms of energy and lassitude; and, while exogenous forces may indeed start, speed up, or slow down the economic machine, they cannot be regarded as the fundamental causes of the recurring booms and depressions of the business cycle. There are, furthermore, adequate and easily discernible causes for the cycle within the economic system itself. The cycle theories we shall examine are all endogenous.

An English economist, R. G. Hawtrey, attributes the cycle entirely or almost entirely to *monetary causes*, to changes in the flow of money as determined by the banks. Irving Fisher finds the main cause of the depression phase in *overindebtedness and deflation*, the overindebtedness of the last stage of the boom bringing the boom to an end, and the deflation working cumulatively with the debts to make the recession and depression worse than they would otherwise be. That is, starting with heavy indebtedness, a deflation sets in; prices fall, raising the debt burden by increasing the value of the money in which the debts are expressed, and forcing debtors to dump "distress" goods, real estate, and securities on the market; thereupon prices fall further, increasing the burden of debts again, and forcing other debtors to sacrifice their holdings, which in turn forces prices lower again.

A number of economists have advanced what may be called an *overinvestment theory* in one form or another. This theory begins with the well-recognized fact that the industries engaged in producing capital goods are subject to far greater variations of activity than consumers' goods industries, rising more in the period of expansion and falling further in the recession. During the prosperity phase there is overinvestment in capital goods in the sense that the rate of investment cannot be maintained without bringing a state of disequilibrium between capital goods and consumers' goods, and finally an end to the boom. The explanation of all this would carry us beyond the limits of this chapter, but part of this theory, as elaborated by some economists, is the acceleration principle discussed earlier in this chapter.

Underconsumption theories, historically the first to appear, have taken various forms. They are often advanced not as specific explanations of the business cycle, but rather as criticisms of the general operations of the capitalist system. Not a few competent students of economics insist that one of the faults of capitalism is that too much wealth and income are concentrated in a few hands, that the rich save so much and turn so much of the national income into investment channels, that the masses of the people, with their inadequate share of the national income, are unable to buy the products which industry could turn out if it were working at full capacity. This is a general situation, not just a cyclical condition; yet if more of the national income accrued to the masses of the people, less would be invested during the prosperity phase and more would be spent for consumers' goods. The economy would be in a healthier condition, and cyclical fluctuations would probably be less violent. This appears to be the general view of Keynes and it is the definite view of J. A. Hobson and Foster and Catchings; but it cannot be concluded that underconsumption is a complete explanation of the business cycle, or that there would be no cycle if wealth were more equally distributed.

This theory obviously has much in common with the overinvestment theory. It appears, however, that during the prosperity phase, particularly the latter part of it, there is an excess of investment over savings, the excess being financed by the banks. Interest rates are high, indicating not an excess but an *insufficiency* of savings. Furthermore, there is evidence that the demand for consumers' goods sometimes *rises* near the end of the prosperity phase, and that it is this, rather than the decline in consumer demand, that brings dislocation and an end to the boom. After the downturn is under way, there is indeed an excess of savings over investment, for businessmen lack the confidence to invest in new enterprises. This excess of savings would presumably not be so great, and the demand for consumers' goods would hold up better, if incomes were more equally divided.

The underconsumption theory sometimes lays stress on the well-recognized fact that wages lag behind prices during the upswing. The argument here is that because of this lag, profits are high, and profits are one source of the funds responsible for the overinvestment. Profits do not represent altogether a subtraction from wages, but partly a subtraction from consumer incomes, which are therefore not high enough to buy the products of the expanded industry; hence the collapse of the expansion process. Here the underconsumption theory runs somewhat parallel to the overinvestment theory which we have already considered.

Psychological theories need not detain us long. All students of cycle theory concede that psychology has an important bearing on the excesses of the boom and depression, but the psychological school stresses this factor more heavily than do others. It emphasizes particularly the role of *expectations* in the cycle. In the expansion phase, for instance, it is the expectations of businessmen, rather than the immediate rate of profits, which lead to overinvestment; and in the recession and depression phases it is their expectations which lead them to venture little or nothing. In the production of capital goods and to a lesser extent durable goods, businessmen must look so far ahead that their expectations are subject to a wide margin of error. Unfortunately there is a great deal of crowd psychology in the business world, for businessmen infect each other with their optimism or pessimism. If they could keep a cool head at all times, they would of course fare much better financially. If late in the prosperity phase they could avoid the contagion of optimism, restrict their investments, and salt down their savings, and if in the recession they could shake off the pervasive pessimism and begin to invest their funds in capital goods, they might make very handsome profits; but of course if all could see the drift clearly and act coolly, little would be left of the business cycle. It is always much easier to tell what has happened than to predict what is going to happen. Although some economists believe that we may some day learn enough about the cycle so that we can avoid some of its worst excesses, it is not reassuring to recall that the worst extravagances of optimism and pessimism were evident in our last business cycle, the "new era" intoxication of the period before 1929 and the paralytic hangover of the years following.

Efforts to control the cycle

The social credit scheme. Various plans have been advanced to eliminate the business cycle or to bring it under some measure of control. One of the most widely advertised is the *social credit* scheme, first advocated by Douglas in 1920, and since then officially adopted, although not actually put into operation, in Alberta, Canada. Starting with the theory that the capitalist system cannot distribute enough income to consumers to keep the productive machinery in full operation, Douglas proposed (1) that retailers be subsidized so that they can sell more cheaply and so dispose of more goods; and (2) that the government declare "national dividends" to all citizens to enable them to buy more, these dividends to be in the form of newly created money. Although this idea has had a considerable number of advocates, it is unsound in more ways than can be mentioned here. It would necessitate ruinously high taxation if the money for the retail subsidies and national dividends were raised by taxes, and it would surely bring disastrous inflation if the funds were secured by issuing money.[2]

Inflation or "reflation." In the depths of a persistent depression there is always much agitation for *inflation*, or *"reflation,"* of the price level; this is urged by some as a means of reducing the burden of debts, which bears heavily when prices are low, and advocated by others as a means of reducing real wages in order to reduce industrial costs and stimulate business. Wages, particularly union wages, lag behind prices on the downswing, and the theory here is that the most feasible way to get real wages down is to raise the price level.

There are objections to this procedure, however. When the depression has been running for a while, the natural forces of recovery are usually strong enough to bring a gradual revival of business which will perhaps be sounder if the government does not try to force it by inflation measures. As for debts, they are indeed a heavy burden in a period of low prices and stagnant business; but toward the end of the depression many of them will have been erased by payment or foreclosure. Price inflation might afford relief to some of those still in debt, but it would be sorry consolation to those who had lost their property to see its value rise in the hands of those who took it over; for them it would be merely piling one injustice on top of another. Even if it were desirable for the government to try to raise prices in this phase of the cycle, it would be difficult to do so. Lowering the Federal Reserve rediscount rate can do little to stimulate bank lending as long as businessmen lack the confidence to expand business operations. Federal Reserve banks may buy securities in the open market and force money into the banking system, thus swelling the amount of the excess reserves; but this cannot induce expansion of bank loans if businessmen lack confidence and do not want to borrow. Efforts to raise prices through the encouragement of bank loans are therefore likely to be largely futile.

"Pump priming." During the Great Depression many people advocated government spending on public works as a means of forcing money into circulation and "priming the business pump." Keynes, who was probably the most important exponent of "pump priming," argued that expenditures for public works will provide not only the employment necessary for the construction of the public works, but by raising the incomes of the people will enable them to spend and invest more, and so will increase employment in business generally, by an amount possibly several times as great as that required for the public works themselves. The "multiplier" which operates to "multiply" the employment cannot be explained here.

There is no general agreement as to the validity of Keynes's theory. Government money spent for public works does provide some employment directly, as long as the expenditures are maintained; but whether government expenditures are likely to generate such momentum in business that private enterprise will go ahead on its own initiative is not certain. Something depends on the source of the funds spent by the government. If the government raises the money by selling bonds, it will probably get some which would otherwise remain idle, but also some which would otherwise have been invested in private business. To the extent that the money comes from idle funds, the government will be increasing investment and employment; but to the extent that the money received would have been employed in private business, it will merely be substituting government investment for private investment. Similarly, if the money is raised by taxation, some of it will presumably represent idle funds, but some of it may be money which the taxpayers would otherwise have invested or spent for consumers' goods. If the government borrows from banks, it will tap sources which would have been largely unused until later in the cycle and will have a definitely inflationary and stimulating effect. If on the other hand the government raises the money by a sales tax, a tax on goods bought, the depressing influence of this tax will presumably balance the stimulating effect of government spending. As a rule, public expenditures will be more stimulating if the money is borrowed than if it is raised by taxation. On the whole, it is not certain that pump priming through public works expenditures results in more business activity and employment in the long run than there would be if the government relied entirely on private enterprise. If the public works are of real value, the expenditure may be justified regardless of its effect on recovery; and this type of work should whenever possible be done during depressions, when there is much unemployment and prices are low.

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[2] See A. H. Hansen, *Full Recovery or Stagnation*, chap. 4.

It might seem that our experience with pump priming since 1933 should provide some conclusive evidence as to its efficacy. Billions of dollars of federal funds were poured into public projects of all kinds; but whether those expenditures really aided recovery is difficult to determine. It is true that there was a measure of recovery and that business conditions improved as long as the flow of government money continued. The national income rose from about 40 billion dollars in 1932, the year before pump priming was adopted, to 60 billions in 1937; consumers' expenditures increased from 42 billions in 1933 to 59 billions in 1936, and expenditures for capital goods doubled in the same period. Yet when the government curtailed its spending in 1937, a severe business recession was soon under way. Apparently business was not prepared to go on under its own power. It is impossible to tell how much of the improvement from 1933 to 1937 was due to government spending, and how much was due to the natural recuperation of business itself. Schumpeter believes that the depth of the depression had probably been reached before the pump-priming policy was inaugurated, and that improvement—perhaps a sounder and more substantial improvement—would have come without it. Hansen reaches the general conclusion, based partly on a study of New Deal pump-priming, that "the process of expansion—upon which pump-priming essentially relies—inevitably peters out," and that perhaps "such expenditures do not 'prime the pump,' but merely keep purchasing power from falling as low as would otherwise be the case." Although not definitely hostile to the policy, Estey comes to somewhat similar conclusions: "This conclusion means that public works will be most effective when they are used as *one* of the armory of weapons available for attacking a depression, not as a panacea for spending our way into prosperity."[3]

Relief spending. Pump priming has been advocated by economists of high repute; but there is another sort of government spending which has been pronounced altogether unsound by practically every economist. Included here are such schemes as the Townsend Plan, which provides for a pension of $200 a month for all citizens 60 years of age and over who have independent incomes of less that $2400 a year; the recipients must spend all the pension and must take no remunerative employment so that jobs may be open for the unemployed. The money for this generous disbursement is to be raised mainly by a 2 per cent tax on all transactions, along with other taxes. Since there are about 13,000,000 people of the specified age, probably 10,000,000 of whom would qualify for pension, the annual cost would be some $24,000,000,000, plus the cost of administering the law and collecting the taxes, a total about two-fifths of the 1939 national income. It would be impossible to collect so much money for any such purpose, and the proposed tax is really a kind of all-inclusive sales tax which would bear with particular weight on persons of small incomes. The vast majority of the consumers taxed would be earning far less than the $2400 given to the old people—$4800 for a couple living together—so the plan is in reality largely a scheme for taxing the many poor to make a few rich.

The Townsend Plan not only would be grossly unfair but would fail entirely as a recovery measure; in fact, it would unquestionably intensify a depression, for various reasons. In the first place, it would so frighten businessmen that they would restrict investment and operations wherever possible. In the second place, by taking money from the poor and lower middle classes, who normally spend almost all their incomes, to give old people a larger income than they could spend wisely, the tax would reduce the amount of spending for consumers' goods.

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[3] See Joseph A. Schumpeter, *Business Cycles*, vol. ii, pp. 983–1026; A. H. Hansen, *Full Recovery or Stagnation*, pp. 121, 296; James A. Estey, *Business Cycles*, p. 456.

Several variations of the Townsend Plan sprang up during the depression, and a few have frightened property-holders out of a great deal of sleep. Perhaps the most famous was the "Ham and Eggs Plan" proposed in California, which promised $25 or $30 every Monday—later changed to Thursday—to the old folks in that state. The state would pay them in state warrants instead of ordinary money, but these warrants could be used as money in buying. To encourage prompt spending, the plan required that anyone holding such warrants must put a two-cent stamp on each dollar warrant every week that it was in his possession. To holders this would have amounted to a 2 per cent reduction in the value of the warrants every week that they were held, which certainly would have kept them circulating. The warrants would have been gifts to the original recipients, who would presumably have spent them promptly; but later holders would have had to give full value in goods or services for them, and in addition all the holders successively would have been obliged to buy during the year a total of 52 stamps for each dollar warrant. This tax, for the entire state, would have amounted to about $1,300,000,000. If it had been adopted, and had been held constitutional, which is unlikely, the scheme would have precipitated a panic or, more likely, would not have been put into effect by state officials.

Stamp money. The Ham and Eggs Plan received no academic support, but "stamp money" has been given the benedictions of two outstanding economists, Irving Fisher and John Maynard Keynes. First suggested by Silvio Gesell, a German merchant of Buenos Aires, the stamp money plan has been strongly commended by Keynes as a means of discouraging hoarding. Gesell proposed a legal requirement that money, to maintain its validity, should have government stamps pasted on each month, to a total of about 5 cents per dollar each year. The purpose of this was to enforce the circulation of money or, as Keynes puts it, to overcome the "liquidity preference" which leads to hoarding. According to Keynes, the rate of interest is determined by the people's preference for liquid cash over investments which tie up funds for a time; and of course the stamp plan would reduce the preference for cash, keep money circulating, and at least tend to reduce the rate of interest. For this reason he assumes that it would increase the amount of investment and employment. Most economists would doubtless consider this plan rather fantastic, but the eminent position held by Fisher and Keynes makes it impossible to laugh off the scheme. Two objections seem pertinent, however. For one thing, it is clear that the mere taxation of cash would accomplish little, since few people carry much actual cash and little of our business is done with it. The scheme would have to be applied to bank balances if it were to be effective, and there would be many difficulties in doing this, for many people do not consider it reprehensible to carry bank accounts for business needs or future emergencies. Then too, if money and bank balances were taxed, people might not invest their money productively, but instead might buy and hoard other "dead" investments like jewels or gold or silver, or they might be more inclined to buy land.

The 100 per cent reserve plan. In recent years another scheme for reducing the extreme gyrations of the business cycle, the 100 per cent reserve plan, has gained the approval of most economists. Requiring banks to keep 100 per cent cash reserves against all deposits and so to restrict loans to the amount of money deposited with them, this plan is designed to prevent or at least temper a boom, and therefore the ensuing recession and depression. With the amount of bank credit fixed, there would be no flexible credit supply with which a boom could be financed. Clearly this would amount to eliminating the banking business as we know it, for it is the essence of banking that banks "create credit" and lend it to borrowers, keeping only a safe margin as reserves. This plan would make the banks little but deposit vaults where customers could keep their money. There would be some lending, of the money deposited; but since the banks would no longer receive interest on loans of credit created by themselves, they would be obliged to charge customers for carrying their accounts, perhaps more than they now do. Customers could make payments by check, up to the amounts of cash they had on deposit.

Intelligent appraisal of the 100 per cent reserve plan requires more knowledge of business cycles and of the whole field of economics than can be expected of most college students; yet a few suggestions may be ventured. Presumably the plan would reduce industrial fluctuations but would not eliminate them entirely. It has been endorsed by so many eminent economists that it must be considered respectfully; but a few of the leading authorities on business cycles are opposed to it. Hansen argues that it would bring more evils than it would cure; that "it may well be that modern capitalism as a system of free enterprise could not survive unless it were permitted to launch forth periodically in just that kind of expansive activity which characterizes the usual boom. . . . Without a flexible credit system, making possible spurts of progress, it seems probable that capitalism would quickly have become rigid, senile, and sterile."[4] It seems possible, on the other hand, that if we run into about one more depression like that of 1929–1939 we shall see the end of capitalism coming in another way. Perhaps our only choice is as to the way by which we will reach the end of our capitalist era. A great many competent economists insist that the Great Depression was not merely an extremely serious cyclical depression, the deepest and most persistent in our history, but that it was symptomatic of the decay and approaching end of capitalism. We shall consider this question in a later chapter.

QUESTIONS

1. Describe the successive phases of the business cycle. Why must each phase inevitably be followed by the succeeding phase? Explain fully.
2. In what various ways are each of the factors in the business cycle cumulative in their action and reaction?
3. What possible explanations might there be for the downturn of the cycle at the end of the prosperity phase?
4. What significance may economic inequality have in the business cycle? In what ways may it weaken the economic system generally?
5. The capital equipment industries have much to do with the downturn at the end of the prosperity phase. Why? Explain the acceleration principle.
6. What are some of the different theories as to the cause of cycles?
7. During a deep depression, is there any sense to the businessman's slogan, "Keep the money circulating"? Would it be good if rich men spent their money freely, even for champagne and circuses?
8. Describe some of the various schemes advanced to eliminate or temper the business cycle. Which of them have had support from economists?
9. Suppose that the government, by the expenditure of 10 billions for public works, can raise the national income by 15 billions; is the expenditure justified?
10. Should the government balance its budget during a grave depression? Why or why not?
11. "Things at the worst will cease, or else climb upward to what they were before." In the business cycle, if things do not "climb upward to what they were before," they do not "cease"; but may they necessitate a shift to another type of economic system? How long could we stand having 10,000,000 men out of work?

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[4] A. H. Hansen, *Full Recovery or Stagnation*, pp. 114, 115.

Chapter 23.

Domestic Trade

Function of trade

In the first chapter we defined production as the creation of utilities, the latter being classified as elementary, form, place, time, and possession utility. Farming characteristically creates elementary utility; manufacturing adds form utility; and trade adds mainly place, time, and possession utility.

Trade truly productive

Trade of most kinds—wholesaling, jobbing, brokerage, retailing—is as truly productive as the work of the farmer. Some farmers do not see this clearly, for some of them think of middlemen as "parasites" who wax rich by widening the price spread between the farmer and the consumer. In some ways the marketing system is wasteful and expensive, but there must be agencies to get goods from farmers and manufacturers to consumers, and the marketing system performs this service passably.

In some cases the original producer performs this service himself. The farmer sometimes sets up a roadside stand and sells his fruits and vegetables to consumers who pass by, or he may even peddle his stuff to the residents of a nearby city. It was once a fairly common practice for farmers' wives to make butter and sell it to certain families in town; and in some of the great city markets today farmers sell their stuff directly to the consumer. In all such cases, however, the farmers have to devote time and energy to their marketing work, and some of them probably do it at a loss. Dairymen near towns and small cities commonly deliver their milk to their customers at a rather high cost. In some types of big business, integrated producers carry on all the functions from manufacturing to selling to the final consumer.

Development of marketing functions

The marketing system, like most of our institutions, has passed through a long process of development. In very early history each family was largely self-sufficient and few goods were marketed; but the fact that Plato and Aristotle gave considerable attention to trade indicates that there was some buying and selling at the time. In medieval times, much of the wholesaling and some retailing were carried on at the great fairs, one of the largest of which was the Stourbridge fair in England, and at what were called *markets*. Families were largely self-sufficient in the early history of the United States, and as recently as two generations ago on the frontier.

Yet there was a little trade, some of it carried on by itinerant tin peddlers, pack peddlers, shoemakers, and the like. A little later, producers of certain goods built shops and turned out goods according to their customers' orders. In the next stage, the retail shop stage, the producers began to make up goods in anticipation of demand, holding them in stock for sale to customers; thus at this stage the producer was also a merchant. The next development was the separation of these two functions, the producer taking over one and the retailer the other. In succeeding stages, middlemen came into the picture; speculative buying and selling increased; great department stores, mail-order stores, and later chain stores arose;

national advertising was developed on a vast scale, and we had our present vastly complicated marketing system. These steps are not to be thought of as clearly marked off into distinct periods, for the historical development differed in various parts of the country, and there was always overlapping. Even today there are vestiges of practically every marketing agency and process that are known historically.

The marketing of wheat

The change from the earlier local and self-sufficient economy to a nationally integrated economy is well illustrated in the marketing of wheat and the manufacture of flour. At one time, only two or three generations ago, farmers took their wheat to one of the local water-power grist mills scattered up and down the rivers, where for a toll the miller ground some of the wheat into flour which the farmers took back with them for their own use. The balance of the wheat they sold to the miller, who ground it into flour for sale to retailers in the vicinity. The business was rather simple, for the community was largely isolated and self-sufficient.

Today the marketing of wheat is integrated on a practically nation-wide scale. A diagram of the marketing system would resemble a spider web, or a myriad of wires bound together in the middle and fanning out at both ends. Several million widely scattered farmers produce the grain and sell it to thousands of local elevators scattered throughout the country; these ship it to a relatively few commission men in the great grain markets, who in turn sell it to the various buyers of wheat—millers, exporters, and speculators. In these grain markets much of the wheat is "processed" into flour, some of which is consumed locally and some of which is sold to wholesalers and jobbers; the latter sell it to bakers, or to the more than 1.5 million retailers, who sell it, mostly in small sacks, to the millions of consumers throughout the country. Thus the wheat, originally grown by many scattered producers, passes through the bottleneck of the commission men and dealers in the grain markets and, in the form of flour, or more generally as bread, already sliced, finds its way back to the nation's many consumers.

The great complexity of the marketing system

The marketing system presents a general picture of almost infinite variety and complexity. There is no uniform channel by which goods find their way from their original producers to consumers, but a bewildering variety of channels. As we have seen, some goods are sold directly to consumers; others are sold to local buyers; still others to brokers, wholesalers, jobbers, commission men, or other agencies, which perhaps sell in turn to other agencies through which the goods finally reach the consumers. Generally, however, there is some economic reason why each particular commodity follows the channel that it actually does, and as a rule we may assume that, under the prevailing conditions, the channel used, if not definitely the cheapest and most efficient, is about as cheap and efficient as any, for in most fields of marketing there is fairly effective competition, although of course not pure competition.

Monopoly and exploitation in marketing

Some monopoly and exploitation there has been in the past, and some there is today. The opportunities for monopoly, racketeering, and other forms of exploitation are greatest in the commission business, in wholesaling, brokerage, and jobbing—in those functions which are farthest removed from the consumer—for commission men, brokers, and wholesalers are often in a position where, in one way or another, they can exploit the farmers who send produce to them. Before the establishment of the cooperative California Fruit Growers' Exchange, some of the commission men who handled this fruit exploited the producers without conscience; in fact, it was because of this exploitation that the Exchange was organized. For example, commission men have been known to open cars of grapes, trample on the baskets enough to spoil a little of the fruit, and then report a large portion of the carload spoiled. In the chapter on monopoly we considered some of the racketeering that goes on in the wholesale markets. In some of these markets the truckers have established monopolistic rackets; in others there has been abuse in the terminal inspection of produce and in the filing of claims for damaged goods. Although monopoly is apparently fairly common in these markets, it would be unfair to emphasize such practices too heavily, for the public is probably already suspicious enough of these agencies.

Functions of wholesalers

The productive functions performed by some of the marketing agencies may be made clearer by answering the questions: Why cannot the farmers sell more of their produce directly to retail stores? Why must the great bulk of it pass through the wholesaler's hands? In the first place, the shipments from the farmers vary widely from one time to another, whereas the retail stores must have a steady supply of goods from day to day. Here the wholesalers add time utility. In the second place, the quality of the produce varies widely, whereas retailers want products of uniform quality; here the wholesalers perform the function of sorting and grading the produce for the retail trade. In the third place, in order to secure low freight rates the farmers must ship their produce in larger quantities than most retailers can use; so the wholesalers distribute it to the retailers, or perhaps store part of it for a while. In the fourth place, business connections between farmers and retail stores are difficult to establish and maintain; and the wholesalers, through correspondence and personal solicitation, can perform this function. In the fifth place, country shippers want cash for their produce; since retailers are often "slow pay," some credit must be extended and the wholesalers are able to afford this. Thus the wholesalers perform a number of necessary functions at a cost of from 1 to 10 per cent of the gross returns. The growth of chain stores, which do their own wholesaling, has caused the business handled by the wholesalers to decline greatly, but nevertheless it is still important.[1]

Functions of retailers

Many people have only a vague notion of the importance of the functions carried on by the retailer. The retailers study the wants of their customers, and at their own risk stock a large number of things in amounts adequate to meet the maximum demand on any given day; they store enough goods, in cold storage if necessary, to have a reserve stock for an extraordinary demand. To some extent they provide expert service in choosing goods which they believe will prove satisfactory to customers, although in general they must have what their customers ask for, rather than what their own judgment suggests as good. They arrange their stocks of goods in such a way that the customer can make his choice with a minimum of time and trouble, and they provide a more or less expert sales force who if necessary can help the customer in making a selection. Retailers may alter certain merchandise to adapt it to the customer's taste; some of them deliver orders to the customer's home, and some extend credit for a month or more. In addition, they may perform various other services for their customers, and for the public in general, as when they help to support the Chamber of Commerce, the Boy Scouts, the churches, and the town band.

Types of retail agencies

In the retail field there is a wide variety of different types of selling agencies, such as independent stores, chains, department stores, mail-order houses, supermarkets, cooperative stores, among other less important types. Unlike manufacturing, the retail business is still largely dominated by the nearly 1.5 million small independent stores, which make about 73 per cent of the total sales. Here and in farming we see the last-ditch stand of the small individual proprietorship which once dominated most of the economic field. The chain stores, which increased rapidly until very recent years, handled about 23 per cent of the sales in 1935, and their proportion of the total retail business grew slowly from that time until the advent of price control in 1942, but since then it has declined considerably. The relative importance of the chains varies with different products, being greatest in the selling of staple articles which permit a rapid sales turnover. The chain variety stores—Woolworth, Kress, Kresge, and others—do 90 per cent of the business in this field; and chains do half of the shoe, automobile accessory, and household appliance business, and about 40 per cent of the grocery business.

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[1] See L. D. H. Weld, *The Marketing of Farm Products.*

Chain stores

There has been much discussion and criticism of chain stores in recent years. They have been fought bitterly by independent storekeepers, who in at least twenty-two states have succeeded in having special taxes levied on them. The merits and demerits of chain stores are worth consideration.

Merits. Chain stores "have clearly demonstrated the benefits of mass buying under central supervision, careful stock control, rapid turnover, central warehousing, intelligent display and store arrangement, standards of cleanliness and quality, effective use of part-time employees, systematic selection and training of the selling force and elimination of nonessential services."[2] By setting new standards in some of these respects, they have jolted independent retailers out of their easygoing traditional ways—and incidentally, in some cases, away from unreasonably high prices. Competition in the retail field was rather lethargic before the chains came along.

Chain stores are able to sell goods cheaper for various reasons. For one thing, they buy in large quantities, and often at considerably lower prices than independent stores can secure; when a purchaser for the 14,000 A & P stores deals with producers he can expect very respectful consideration, and frequently some concessions in prices. Under the Robinson-Patman Act producers are forbidden to sell cheaper to chains than to other buyers unless it can be shown that the chains have legitimately earned such discounts through savings made by buying in quantity; but substantial discounts have nevertheless been allowed under the act—in one case, 14 to 18 per cent on rugs bought by Montgomery, Ward & Company.

There are other reasons why the chains can sell more cheaply than the independents. They have a larger volume of sales and hence a more rapid turnover, and they can often save money by eliminating other middlemen and buying direct from producers. The central office can afford to hire experts in such functions as buying stock, advertising, and arranging goods for display, and thus the chain can perform these functions better and more cheaply than the independent stores. Doubtless the chains get more work out of their sales force than most independents, and often they train them better; a chain store is a busy place, and the manager usually works hard. Finally, the chains usually offer only "cash and carry" service which, although inferior to the service provided by the independents who deliver orders and extend credit, is considerably cheaper. If buyers at chain grocery stores marked up against their purchases the cost of using their automobiles and the value of their time, they would find in some cases that they pay as much as they would at an independent retailer, if not more.

Demerits. Chain stores have been criticized on many points, but some of the criticisms have failed to be substantiated by investigators. Thus the chains are sometimes accused of paying low wages; but although the wages paid by some of the variety chain stores, where little training is required, are very low, it appears that the chains pay about as much, on the average, as the independents. They are often accused of selling inferior products and short-weight packages. The Federal Trade Commission, however, has found no definite justification for this charge. They have been condemned for selling "loss leaders" below a reasonable markup and in some cases at an actual loss; but this is a fairly common practice in retailing and is probably not very reprehensible. Their advertising policies have been criticized, but here again the Federal Trade Commission has found nothing illegal.

The hoary argument that the chains "take the money out of town" whereas the independent stores "keep it at home" is largely based on fallacious reasoning. The chains do send their net profits to the main office in some great financial center, whereas the independent retailers may keep their profits, if any, in the home town; but the salaries of the chain-store managers (perhaps with a percentage of the profits) which are somewhat higher than the independent's profits, are spent mostly in the home town, as are the wages of the other chain employees. The net profits of the chains which are sent to the main office constitute a very small percentage of the total received from customers. Both chains and independents must, of course, send away from the home town all or most of the money needed to buy goods.

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[2] Twentieth Century Fund, *Does Distribution Cost Too Much?* p. 82.

The truth is that in the long run, to the extent that the chains really sell at lower prices because of superior efficiency, they doubtless raise the standard of living of the people generally, just as other particularly efficient economic agencies do—engines and machines, for instance. To the extent that they are more efficient than the independents, they release labor for other productive functions and so, like other labor-saving agencies, increase the amount of goods produced; and by selling at lower prices, they enable consumers to buy more. In the long run, to the extent that they are really more efficient, they may even raise the income of independent retailers. They of course drive out some of the independents; but, if by their efficiency they raise the general standard of living, the independents who are left should gain in the long run, because their income cannot remain indefinitely below that of other equally efficient men. Heretical as it may seem, the spread of such mass-distribution agencies as the Woolworth and Kress stores doubtless raised the real incomes of independent merchants, although it reduced the number of them.

The "keep the money at home" argument has long been standard artillery in fighting the big mail-order houses. Where they have retail units in fair-sized towns, the mail-order houses are like other chain stores, and the above analysis applies; but what of the argument in towns where there are no mail-order units? What is the long-run effect on such a community when consumers send to Sears, Roebuck & Company for goods? This is not quite like buying from Woolworth or an A & P, because Sears, Roebuck perform the marketing function in a distant city. Clearly the result of ordering goods from them is to transfer some business from the local town to the distant city. Not only is the profit made in that city, but the manager and all the employees live there too. This logically should lead to a reduction in the number of merchants and employees in the local town, and will make it smaller; but if Sears, Roebuck really render the service more efficiently and cheaply, the standard of living in the town should in the long run be higher than if all the townspeople bought everything from the local merchants. The real income even of the merchants left in the town should be higher. There are possible exceptions, however, to this general conclusion. For example, if by buying from Sears, Roebuck, consumers drive out merchants who sell some essential commodities which cannot be bought by mail, the townspeople may be in a worse situation than if they bought everything from the local merchants.

A much sounder argument against chain stores than the common complaint that they take money out of town lies in the fact that they doubtless tend to divest a town of its local economic autonomy. Like big business generally, they tend to make a town or city merely an economic colony of the great financial centers from which the chains and mail-order houses are controlled, a colony inhabited partly by employees of the chains who do not have the same pride and interest in the community that independent storekeepers do. Again like our big, highly integrated business enterprises, the chains are efficient; but they tend to centralize wealth and economic control, to make hired men of some who once had the opportunity for modest individual entrepreneurship, and to rob the community of local leadership, dignity, pride, and responsibility. Whether their price economies are compensation for these losses is a matter of individual judgment.[8]

Conclusion. Our general conclusion as to chain stores perhaps should be that it would be unfortunate if they were driven entirely out of existence, and equally unfortunate if they should take over the retail field completely. If there were no chains, some independent retailers would build up local monopolies to exploit consumers, just as some of them did before the chains appeared. On the other hand, if the chains controlled the retail field entirely, they might combine in another form of monopoly. The present competition between chains and independents is healthful for both of them.

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[8] *Ibid.*, pp. 81–85; Helen Dallas, *Chain Stores—Pro and Con*, Public Affairs Pamphlet No. 40.

Retailer cooperatives

As a result of chain-store competition, many individual retailers have combined in *retailer cooperatives*—not to be confused with true cooperatives like those in Sweden—and in *voluntary chains*, which enable them to retain their individual ownership but to use chain-store tactics and strategy such as group advertising, private brands, suggested price lines, uniform stock merchandising and control, and uniform store fronts. Although these cooperatives do only a small proportion of the total retail business, they have grown rapidly since 1929, and they may prove to be the means of staying the advance of the chains.

Supermarkets

The most recent major development in grocery retailing is perhaps the appearance of the immense stores known as *supermarkets*, some of them independent, some operated by wholesalers or by chains, and others operated as retailer-owned cooperatives or wholesaler-sponsored voluntary chains. Some of them were originally established in abandoned factories or warehouses in outlying districts and equipped with cheap fixtures to make a strong economy appeal; but recently many of them have moved to congested areas and have built attractive and handsomely equipped headquarters, with parking space for customers. For those who do not mind driving some distance, these supermarkets offer a wide selection of foods, some of which the ordinary grocer could not afford to carry in stock. Here is big business in another form and, like the chain stores, the result of machine technology, the automobile.

Retail specialization

In large towns and cities, retailing is often specialized, not only according to the merchandise carried—shoes, men's clothing, furniture, and the like—but according to the quality of the goods and services offered to the public. Some retailers seek the trade of people of high incomes by offering a wide selection of generally high-quality goods, with high-class service—prompt, courteous attendance on the customer by intelligent salesmen or saleswomen—and with generous opportunities for the customer to purchase merchandise on approval, free delivery, and credit. Prices are likely to be high in such stores, perhaps high even in relation to the quality of the goods, for such service is expensive; yet some people are glad to pay these prices. Other retailers, as for instance the Woolworth and Kress stores and the big mail-order houses, appeal to the masses of people of small or moderate incomes by offering a somewhat narrow selection of fair or even inferior quality goods, with poor, slow service because the sales force is inadequate and poorly trained. Their customers usually have to do for themselves much that is done for them in the more expensive stores, and they pay cash and usually carry their purchases home. Most of the chain stores operate on this basis, and their prices are generally low because their expenses are low.

The cost of marketing

One of the commonest criticisms of our marketing system is that it is too expensive, that the price spread between the original producer and the consumer is too great. According to a study made in 1939, it cost considerably more on the average to distribute goods than it does to make them, for about 59 cents of the consumer's dollar goes for distribution and only 41 cents for production.[4] Of the 66 billion dollars paid by consumers for finished goods in 1929, 27 billions was paid for making them, and 39 billions for distributing them. Of the 39 billions, 13 billions went to retail distribution, 7 billions to the wholesale trade, nearly 9 billions to transportation, 1 billion to advertising, installment selling, and other charges, and a little more than 9 billions was the distribution cost of manufacturers. As for specific commodities and types of commodities, it cost three or four times as much to bring vegetables and fruits from the farm to the dinner table as it did to grow them. The farmer got seven-tenths of a cent per pound for cabbages for which the housewife paid four cents; he got one cent for a bunch of carrots for which the housewife paid five and a half cents; he received less than nine cents for oranges which sold in the markets for 31.8 cents. The farmer received 18.7 cents of the consumer's dollar in the sale of canned tomatoes, and only 13.3 cents of the dollar paid by the consumer for bread. In the marketing of eggs and meats, he received a much larger share of the price to the consumer —more than half. In most manufactured products, the producer got a somewhat larger share of the final price; but electric refrigerators manufactured at a cost of $58 were sold at $156, with the retailer taking $70—more than the cost of manufacturing.

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[4] Twentieth Century Fund, *Does Distribution Cost Too Much?*

Relative increase in costs

Distribution costs are high, and they have been increasing, not only absolutely but relatively to manufacturing costs. Between 1870 and 1930, the total volume of goods produced and consumed in the United States increased 900 per cent, and the number of people engaged in distribution increased nearly 900 per cent; but the number engaged in production increased only 300 per cent. This indicates that the output produced per worker trebled, whereas the amount of goods distributed per worker increased only slightly. There are a number of reasons for this. In the first place, employees engaged in marketing and in distribution, except transportation, have profited little from the development of machines and the increased use of power; the salesman in a grocery store is still a hand worker. In the second place, distribution today covers much larger territories and must "reach more people with an almost infinitely wider variety of products." In short, as the Twentieth Century Fund summarizes the change: "While specialized quantity production in highly concentrated areas has resulted in lower costs and increased efficiency in production, it has at the same time made distribution more complicated and costly. Concentration of production requires the transportation of raw material to producing centers and of finished products back to dispersed and distant markets. This transfer takes time, requires intermediate handling and financing, and involves risks and costs not present in simpler types of economy."[5] Here is another aspect of the machine age.

Wastes in the marketing system

There are wastes in the marketing system, as in all human institutions. The Twentieth Century Fund lists them as follows: (a) Duplication of sales efforts, multiplicity of sales outlets, excessive services, multiplicity of brands, and unnecessary advertising, all caused by monopolistically competitive conditions; (b) unreasonable demands and misinformed buying on the part of consumers; (c) lack of proper knowledge of costs among distributors themselves, too great zeal for volume, poor management and planning, and unwise price policies. It is significant that such staple, standardized products as wheat, corn and cotton are marketed much more cheaply than are differentiated, branded products.

Cooperative marketing

European cooperatives. Cooperative marketing has often been advocated, and to some extent carried into effective operation, as a means of reducing the wastes of competitive marketing. The most successful form is seen in the consumers' cooperative stores, which have nearly a century-long record of success in Europe, dating from the Rochdale cooperative which was established in England in 1844. The principles set up to govern these stores are still recognized as sound: (1) Unrestricted membership and democratic control, with each member entitled to one vote regardless of the number of shares owned. (2) Sales at regular market prices, with all profits returned to the member-customers on the basis of the amount of their purchases. By selling at market prices, the cooperatives try to avoid antagonizing private business. (3) Modest dividends on stocks. (4) Sales for cash only, to avoid credit losses; and no delivery service.

From its modest beginning in 1844, the Rochdale consumers' movement has grown until in 1938 over 5,000,000 families, mostly those of industrial workers, were enrolled in England. That year retail cooperatives in England handled more than 1.25 billion dollars' worth of business—about 10 per cent of the total retail trade of the British Isles—and paid patronage dividends of 80 millions to members. They constitute a vast organization with thousands of local stores; with wholesale houses, factories, flour mills, ocean steamers, fishing vessels, and tea, coffee, palm, and olive plantations; and a cooperative bank which reports assets of 500 millions

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[5] *Ibid.*, pp. 17–18.

Other European peoples have built up strong cooperatives. The International Cooperative Alliance, which includes agricultural and industrial producers' cooperatives as well as consumers' cooperatives, has affiliates in 38 countries, with a total membership of more than 70 million people. It is estimated that these cooperatives do an annual business amounting to about 20 billion dollars. The movement is exceptionally strong in the Scandinavian countries. In Finland, cooperatives handle about 30 per cent of the retail trade, and in Sweden 15 per cent; and they did from 10 to 20 per cent of the business in Norway, Denmark, and France before the German occupation. The largest cooperative system in the world, however, is in Russia, where cooperatives with a membership of 39 millions do a business of more than 20 billion rubles, or about half the retail trade of the country districts.

Sweden has been widely advertised as a sort of economic Valhalla, happy and prosperous largely because of her cooperatives; and while there has been some exaggeration as to the amount of cooperation and the benefits gained, her record is impressive. Not only have her cooperatives cut some of the costs of retailing, but they have gone into manufacturing to fight monopolies in flour milling and in the production of margarine, electric light bulbs, cash registers, and rubber goods.[6]

Cooperatives in the United States. Cooperative marketing has not been as successful in the United States as in some European countries, yet our record is rather impressive, particularly for farmers' cooperatives. In 1944 there were in this country some 10,450 farmers' cooperative associations, with a total membership of approximately 1,500,000, or about one-fourth of our total number of farmers; and these associations sold more than 3 billion dollars' worth of farm products and bought for their members supplies amounting to $750,000,000. They marketed about 40 per cent of the butter produced, 75 per cent of the fluid milk, 20 per cent of the livestock, 15 per cent of the wool, 6 per cent of the eggs, 2 per cent of the chickens, 17 per cent of the turkeys, 55 per cent of the citrus crop (in California, 80 per cent), 50 per cent of the grain, 30 per cent of the rice, and a substantial proportion of the cotton, nuts, and fruits other than citrus.

Urban consumer cooperatives have not been as successful as farmers' cooperatives; but in recent years they have been growing, and in 1942 they did a total retail business of about $564,000,000.

A number of services other than buying and selling are provided cooperatively. Various cooperatives provide housing, medical care, burial services, cold storage, water for household use and for irrigation, printing and publishing, recreation, electricity, telephone service, credit, and insurance. In 1944, some 2000 farmers' mutual fire insurance companies, with 3,000,000 members, were reported as carrying $14,000,000,000 of insurance.[7]

Advantages and disadvantages of cooperatives. At its best, cooperation offers certain definite advantages. If its members are loyal, their cooperative can avoid some of the wastes of monopolistically competitive marketing. For example, it can handle goods which do not have to bear a heavy expense for advertising and promotion, and since it is in business for service and not for profit, it can carry honest goods of real quality. If it is very strong, as in certain European countries, it can maintain a laboratory to test and grade goods, and can offer its customers a high grade of service. Indeed, such a strong cooperative may enjoy the general advantages of big business without the temptation to convert those advantages to private profit.

Some idealistic spirits look forward to the time when cooperatives will dominate the marketing field, and perhaps production as well. But cooperation is not merely a way of distributing goods; it is a means of developing generous idealism and civic intelligence. It represents a shift from the acquisitive ideal, for working together in cooperatives develops in the members a capacity for unselfish action and an understanding of economic problems. The educational work carried on by the Scandinavian cooperatives is doubtless in part responsible for the high level of economic and political intelligence characteristic of those countries. By forcing reductions in the prices of monopolized articles, their cooperatives have had some success in reducing economic inequality and have therefore tended to make the economic system of those countries work better. Sweden suffered much less than most European nations in the Great Depression.[8]

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[6] Maxwell S. Stewart, *Cooperatives in the United States—A Balance Sheet,* Public Affairs Pamphlet No. 32.

[7] U. S. Bureau of Labor Statistics, *Bulletin No. 757;* Speech by Joseph G. Knapp, Principal Agricultural Economist, Cooperative Research and Service Division, Farm Credit Administration, USDA, Before the Conference on International Cooperative Reconstruction, January 19, 1944; John Daniels, *American Cooperatives, Yesterday—Today—Tomorrow.*

There are, however, grave difficulties in the way of cooperative marketing. Many of the most successful cooperatives owe their success to the loyal and unselfish service of some able man or men who were glad to work for less than they might have earned in private business; but such men are not always available, and many cooperatives have found difficulty in developing and maintaining efficient management. However able the management, the cooperative may fail if its members are not loyal, that is, if they do not patronize it consistently. Cooperation is like government activity in that it can maintain efficiency only if the members, like the voters, take a keen interest in what is being done.

Whether American cooperatives can ever be as successful as those of the Scandinavian countries is doubtful. The Scandinavians are more homogeneous, and their social and economic life is simpler and more stable. As Slichter has said: "The contempt of Americans for small economies, the individualistic tradition, the weak development of class consciousness among wage earners, the numerous racial groups, the mobility of the population, the large chain stores, department stores, and mail order houses with their extraordinarily effective marketing methods, and their 'bargain counter' appeals, the aggressive hostility of jobbers and retailers, all have hindered the development of cooperatives."[9] Nevertheless, the cooperative movement in this country should be given all possible encouragement. Indicative of the cultural significance of the movement is the fact that Fascist dictators, with their characteristic hostility to civilized and civilizing institutions, broke up the cooperatives not only in Germany and Italy but in all the countries they conquered. Germany had a powerful cooperative movement before Hitler's rise to power.

Socialization of the marketing system

Socialism is also sometimes advocated as a "cure-all" for the wastes in our present marketing system, but how effective it would be is not certain. It is true that a really efficient socialist government could eliminate some of the wastes of competitive marketing or, better, of monopolistically competitive marketing. Such a government could reduce the fantastic number of sizes and styles and brands of most goods at least 75 per cent, with little or no loss to consumers; it could standardize some goods and label them correctly, so that consumers would know what they were buying; it could eliminate the spurious, inferior, and overpriced goods so commonly sold in a capitalist economy; it could eliminate most of the wastes of competitive advertising and salesmanship. In a given city it could organize the grocery business with a great central market and a warehouse for reserves of food, with branches in various parts of the city and unified delivery and credit systems, thus saving in the volume of stock carried, in advertising, in delivery services, and in credit losses. There would not be a dozen delivery trucks sputtering along every city street, and no dead beats would run up bills at one store and then shift to another. Thus a really efficient socialist government could save in many ways; but it is not certain that a socialist government would be really efficient. It might fall into the unprogressive routine of some of our present government agencies; it might be less responsive to public wants and whims than our present system, although this might not be a serious loss; the managers and employees might be less alert and energetic; for these and other reasons, many of the possible economies of integrated organization might not be realized. If the retailing business were largely monopolized, there would be good reason for socializing it, but it is severely although not purely competitive. In a regime of moderate socialism it would probably be left in private hands.

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[8] See Marquis W. Childs, *Sweden, the Middle Way;* and Harry Laidler, Consumers' Cooperation—A Social Interpretation, New Frontiers, Vol. V, No. 5; May, 1937.

[9] Sumner H. Slichter, *Modern Economic Society,* 1st ed., p. 79.

QUESTIONS

1. By what process, precisely, do advertisers and salesmen create a demand for new styles of clothing? For vitamins? For Jergens Lotion?
2. Why is the marketing function much more important than it was even fifty years ago?
3. Outline some of the important functions performed by retailers. By wholesalers.
4. Why do not producers more commonly market their own products?
5. Is there any reason to believe that our present marketing system is about as efficient as it can be without close government regulation? If economies could be secured by eliminating some of the middlemen, would not someone be likely to try to do that? Where might the *government* secure some economies?
6. On the basis of the following analysis of the money we spent for food in 1935,[10] does the marketing of goods cost too much? Discuss fully.

	Millions	Per Cent
Farmer's share	$ 5,593	41.1
Processor's share	2,739	20.1
Wholesaler's share	1,232	9.0
Retailers' share	3,337	24.5
Transportation	728	5.3
	$13,629	100.0

7. Why have marketing costs risen in the past few decades? Does their rise mean that consumers are getting less for their money or that producers are being exploited?
8. There are more than ten times as many brands and varieties of some products as are needed to meet the most exacting consumer demand. Could the government enforce a 90 per cent reduction in the number of them and so reduce the cost of marketing? What difficulties would it encounter?
9. "When you buy from chain stores you have the goods but the community loses the money; when you buy from a home-owned store you have the goods and the community has the money too." How much truth is there in this argument? What is a sound argument against the chains? If all the retailing were handled by chain stores, of whom would the population of a town consist?
10. Chain stores offer services which in some respects are inferior to those offered by individual merchants, but their prices are lower. What classes of people would you expect to see buying in chain stores?
11. What are the essential principles of cooperative marketing? Why have cooperatives been less successful in the United States than in many European countries?
12. "The Woolworth stores have raised the standard of living not only of the people generally, but of local merchants themselves." Do you agree? Why or why not?
13. The cooperatives that do a big business can secure the same economies that big business generally enjoys, and they may do even better for consumers in some ways. In what ways?
14. Assuming that the people in Kansas produce only wheat, what would be the effect on their income of a 50 per cent reduction in the population of the state, the population and productive occupations of all the other states remaining the same? Under the same assumptions, what would be the effect of a 50 per cent increase in the population of Kansas?

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[10] National Resources Committee, *The Structure of the American Economy*, p. 379.

Chapter 24.

International Trade and Exchange

INTERNATIONAL TRADE

International trade is essentially the same as domestic trade. Contrary to a fairly popular misconception, it is not trade between two *countries*, except in the case of totalitarian countries, or among a large number of countries, but normally is carried on by *individuals* in different countries, just as domestic trade is carried on by individuals in the same country, each seeking a profit by buying and selling. If the United States should break up into her constituent states, each becoming a separate nation, much of the trade which is now domestic would become international; and if the countries of Europe should adopt a common monetary system and abolish all tariffs, trade would be carried on in the same way as domestic trade is in the United States. It is in the adjustment of the values of different moneys and in the political interference with commerce that international trade differs from domestic trade.

Bases of international specialization and trade

International trade, like domestic trade, is as definitely productive as any other economic activity. Through it, the people in all the countries of the world are able to have more goods than would be available without it. Nearly every country has particular advantages in the production of certain commodities, and international trade makes these commodities available to people in other countries more cheaply than the other countries could produce them. The nature of these advantages must be considered in some detail.

In the first place, the climate of the various nations differs greatly, particularly in respect to temperature and the amount and character of the rainfall. Only in hot climates can such commodities as coffee, cane sugar, rice, rubber, bananas, and citrus fruits be produced. Some of these can be grown in the southern part of the United States, but such products as coffee, rubber, and bananas have to be imported. On the other hand, certain other products, as for instance furs and many kinds of lumber, can be produced only in temperate or cold climates. All the products for whose production certain climatic conditions are necessary can be made available to the world as a whole only through trade.

In the second place, the mineral resources of the various nations differ greatly; for example, the United States, Russia, Venezuela, Mexico, Iraq, Rumania, and a few other countries have almost all the world's known oil reserves. The wide distribution and use of many essential minerals depend on international trade.

In the third place, the population densities of the various nations differ so greatly that these countries vary to a marked extent in their typical economic activities and products, and much of the world's trade is based on these differences. Sparsely populated countries, such as Canada, Australia, the United States, and the South American countries, can engage in extensive production—using natural resources freely and labor scantily—but they can scarcely afford to produce things that demand much hand labor, such as hand-carved furniture and handmade lace. Such countries can generally produce meats and grains very efficiently, and other products that call for much land and little labor; and the countries which, like the United States, have an abundance of coal, lumber, and minerals are also efficient in the production of heavy goods that call for relatively little labor. But in densely populated countries—that is, densely populated in relation to natural resources—most farm products are scarce. Since little land is available, labor must work with small tracts of it, and its productivity is low. In such countries, however, labor may be just as efficient as elsewhere in turning out handmade articles, and the people can secure many food products far more cheaply through trade than by producing them on the scarce land. Differences in population density provide the basis for great gains in trade, gains which will be possible as long as the differences persist.

There are a number of other advantages which may form the basis of international trade. A country may have developed a certain industry early, have a long record of successful production, and have developed a class of labor that has well-ingrained traditions of specialized skill, as the result of which the country may have world-wide prestige for its product which enables it to reach world markets at good prices. This was true of the English cotton and woolen industries and the French silk industry for a long time. Where there are no natural advantages, however, the country is likely to lose its preeminence eventually, as the British textile industry did. American automobile manufacturers similarly have the great advantage of a vast home market and are thus able to produce on a scale that affords maximum economies and probably lower costs than are possible elsewhere. Such an advantage may be expected to last until some other country develops automobile manufacturing on a scale sufficient to bring costs down to the American level.

Absolute vs. comparative advantage

Absolute advantage. The relative advantage of different countries in the production of various goods may be either *absolute* or *comparative*. It is absolute when each of the countries in a given trade can produce the commodity it is exporting at less cost, in terms of productive agents, than the country with which it is trading. In exchanging automobiles for Cuban sugar, the United States has an absolute advantage in producing automobiles, whereas Cuba, because of her climatic conditions, has an absolute advantage in producing sugar. Labor, with its ordinary supply of land and capital, is absolutely more efficient in producing automobiles in the United States, and absolutely more efficient in producing sugar in Cuba. We shall often refer to the efficiency of labor in the present chapter, but it must be understood that this refers not to any peculiar superiority of the labor itself, but to its effectiveness, which is largely attributable to conditions for which labor is not responsible, such as the amount of capital or land with which it works or the efficiency of the entrepreneur who organizes production. In the case of the Cuban worker, it is the climate that makes the labor productive.

The increase in total output of goods that results from trade between two countries enjoying an absolute advantage in production may be illustrated by a hypothetical example. Let us suppose that labor in the United States is ten times as efficient in producing pork as labor in China, but only half as efficient in producing toys. Suppose that an American laborer (farmer) can produce 5000 pounds of pork each year, and a Chinese laborer only 500 pounds; and that an American laborer can produce 500 toys and a Chinese laborer 1000 toys. What will be the total product of 100 laborers in each country, first, if there is no foreign trade, and second, if there is free trade?

No Foreign Trade

50 American laborers produce	250,000 pounds of pork
50 American laborers produce	25,000 toys
50 Chinese laborers produce	25,000 pounds of pork
50 Chinese laborers produce	50,000 toys
Total product:	275,000 pounds of pork
	75,000 toys

Now let us assume free trade and international specialization, with American labor devoted to pork production and Chinese labor to making toys.

Free Trade

100 American laborers produce	500,000 pounds of pork
100 Chinese laborers produce	100,000 toys

It is clear that free trade almost doubles the production of pork and increases the production of toys from 75,000 to 100,000. Obviously there is a great gain from free trade under the assumed conditions, although transportation costs must of course be deducted.

Comparative advantage. Much foreign trade depends, however, not on absolute advantage but on comparative advantage. Labor in the United States, with the ordinary supply of land and capital, may be as efficient as that of another country, or even more efficient, in the production of a certain commodity, and yet we may import that commodity if our labor has a *still greater comparative advantage* in producing something else. In the case of American-Chinese trade, let us assume that a given amount of American labor produces ten times as much pork but only the same number of toys as an equal amount of Chinese labor. The following tabulation shows the respective outputs when there is no foreign trade and when there is free trade:

No Foreign Trade

50 American laborers produce	250,000 pounds of pork
50 American laborers produce	50,000 toys
50 Chinese laborers produce	25,000 pounds of pork
50 Chinese laborers produce	50,000 toys
Total product:	275,000 pounds of pork
	100,000 toys

Free Trade

100 American laborers produce	500,000 pounds of pork
100 Chinese laborers produce	100,000 toys

Here free trade and specialization have added 225,000 pounds of pork, but no toys. There has been a great gain, because the Americans and the Chinese have nearly twice as much pork as they would without trade, and just as many toys. Presumably labor would be shifted about in such a way as to produce more toys as well as more pork. Here again, transportation costs must be subtracted.

Even if American labor were more efficient in toy-making than Chinese labor, Americans, in accordance with the principle of comparative advantage, might gain by devoting themselves entirely to pork production and trading pork for toys, if they have a greater comparative advantage in producing pork. According to this principle, a country may import goods which it can produce more efficiently than the country from which it imports; just as a lawyer may hire a stenographer even though he is more efficient in stenography than she is. He may have a greater comparative advantage in practicing law.

Let us apply our hypothetical illustration in this situation. Let us assume that American labor is ten times as efficient in pork production as Chinese labor, and twice as efficient in toy-making. What will be the total production of 100 laborers in each country, with no international specialization and no trade, and with free trade?

No Foreign Trade

50 American laborers produce	250,000 pounds of pork
50 American laborers produce	100,000 toys
50 Chinese laborers produce	25,000 pounds of pork
50 Chinese laborers produce	50,000 toys
Total product:	275,000 pounds of pork
	150,000 toys

Free Trade

100 American laborers produce	500,000 pounds of pork
100 Chinese laborers produce	100,000 toys
Total product:	500,000 pounds of pork
	100,000 toys

Here we have gained 225,000 pounds of pork by trading, but have lost 50,000 toys. Does the gain of 225,000 pounds of pork more than balance the loss of 50,000 toys? The answer is clearly in the affirmative. At either the American or the Chinese ratio of labor costs of pork and toys there is a net gain. At the American cost ratio, the labor cost of 225,000 pounds of pork is the same as that of 90,000 toys. Only 50,000 toys were lost, so the gain from the trade is equal to 40,000 toys or 100,000 pounds of pork. At the Chinese cost ratio, the labor cost of 225,000 pounds of pork equals that of 450,000 toys, 400,000 more than were lost through trade. At the Chinese ratio, the labor cost of 50,000 toys equals that of only 25,000 pounds of pork, and the loss in toys is therefore equal to that of only 25,000 pounds of pork, leaving a gain of 200,000 pounds. Thus at either the American or the Chinese ratio of costs, there is a gain from the trade, a gain which can be realized in pork or in toys, or partly in both.

To make our hypothesis real and complete, we should have to add to the labor costs the costs of the capital and land used in production; but we need not do that here, for it would not change the fundamental principle involved.

To look at this from another angle, suppose an American wants a hand-embroidered dress for his wife and that he can buy it from an American maker for $100, whereas a Chinese girl will make it for $10. If he buys the American-made dress for $100, he must pay the wages of 200 hours (at 50 cents an hour); but if he buys the Chinese-made dress he will send the wages of only 20 hours of American labor to China to pay for it. If Americans produce the things in which they have the greatest comparative advantage—wheat, pork, beef, steel, oil products, farm implements—and send them to China in exchange for handmade goods, they can get the latter at far less cost, in labor or in money, than if they buy American-made goods, or they can get more goods. On some products the gain would be ten to one, on others less; and there is no less employment in America, no less work to be done, than if we bought nothing from China. We would merely be devoting our energies to producing the things in which we have the greatest comparative advantage, and we would trade them for those articles in which our comparative advantage is less or we are at an absolute disadvantage.

Of course Americans would not get all the gain from such exchange. The Chinese people would have to gain too. They would gain by receiving more for their exchangeable goods than they otherwise would. They could have more and better food and clothing, more and better tools and implements made from American steel. They could live better. In fact, to the extent that they engage in foreign trade, they do live better. Just how the gains would be apportioned between the two peoples would be determined by a great many factors which cannot be discussed here; but both parties to the exchange would have to gain or the trade would not be carried on.

It is fairly clear that the trade between sparsely populated countries, such as the United States or Canada, and densely populated countries, such as China or Czechoslovakia, is based largely on the principle of comparative advantage. There is no reason to believe that American labor could not learn to make toys and laces and handmade gimcracks as well as Chinese or Czech labor, if it could do nothing better; but with our great abundance of land and natural resources, it has a comparative advantage in producing farm produce and heavy industrial products in which abundant natural resources are an important element.

International trade is thus a means of securing the advantages of international specialization, international division of labor. It is like territorial division of labor within a country. One of the reasons for the high income of the people of the United States is the fact that our large area permits regional or territorial specialization, with consequent increased output of goods.

The following are some of the important export and import items for the United States in 1939, a prewar year, in millions of dollars:

Exports	
Machinery, all classes	$502.2
Petroleum and products	383.7
Automobiles, including parts and accessories	253.7
Cotton, unmanufactured	243.5
Iron and steel products	235.5
Chemicals and related products	164.7
Aircraft, including parts and accessories	116.9
Grains and preparations	99.5
Copper, including ores and manufactures	97.2
Fruits and nuts	83.2
Tobacco, unmanufactured	77.4
Cotton manufactures, including yarn	68.3
Coal and coke	66.7
Packing-house products	54.8
Iron and steel, advanced manufactures	49.8
Imports	
Crude rubber	$178.0
Coffee	139.6
Paper and manufactures, mostly newsprint	126.8
Cane sugar	124.6
Raw silk	120.9
Paper base stocks	88.4
Chemicals and related products	79.5
Tin, bars, blocks, and pigs	70.6
Fruits and nuts	58.2
Furs and manufactures	55.5
Vegetable oils, expressed	50.9
Wool and mohair, unmanufactured	49.7
Whisky and other spirits	48.3

Hides and skins	47.1
Diamonds	45.1
Copper, including ores and manufactures	44.5
Petroleum and products	43.5
Cotton manufactures, including yarn...	39.6

These figures show that the United States is no longer mainly an exporter of food products and raw materials, or mainly an importer of manufactured products. On the contrary, we export vast amounts of manufactured products, along with cotton, grains, petroleum, and fruits; and we import large amounts of raw materials and food products.

Foreign Exchange

International trade, although essentially like domestic trade, differs in the superficial but often confusing fact that the various countries use different monetary systems. It achieves the same results as barter—the exchange of goods and services for other goods and services—but the goods are sold for money which must be exchanged for the money of another country. The process by which payments are made must first claim our attention.

Trade may be carried on between two countries both of which are on the gold standard, or it may be carried on between countries whose monetary systems are unrelated to each other by any common denominator such as gold. Before the First World War, nearly all the important countries of the world used gold, but today practically all of them have abandoned the gold standard and are using a paper standard, perhaps in some way related to gold. In both situations, trade is carried on mainly by private individuals. The rise of dictatorships in recent years, however, has created a third situation in which the trade is carried on as international barter and is governed entirely by the will of the dictators, with little reference to international monetary values or economic forces. We shall consider these three situations in the order mentioned, taking up first the trade between countries on a gold standard. The student may wonder why we should consider this, since the gold standard has been generally abandoned; but discussion is necessary because the standard money (paper) of most countries is still defined in terms of gold, and in most countries prior to World War II it was redeemable in gold for the purpose of making international payments. In our first case we shall assume that the countries are on a gold standard.

International trade, with gold standards: bills of exchange

In international trade the typical instrument of payment is the *bill of exchange*, which Myers has defined as "an order to pay money, drawn against a foreigner, payable in the foreigner's money, and payable in his country."[1] It is an order drawn by the exporter against the foreign importer to pay a certain amount of money to a third party, such as a bank with branches in both countries. To use a simple illustration, an American exporter shipping a cargo of wheat to a British importer draws a bill against the importer, ordering him to pay the amount due, in British pounds, to a certain bank which handles the exporter's banking business. This bill may be a *sight* bill, calling for immediate payment, or a *time* bill, calling for payment in a specified time, perhaps thirty days. A time bill that has been *accepted*, in this case by our British importer, is often bought as a short-term investment by some bank that deals in foreign exchange. By accepting the bill, the importer acknowledges its validity and agrees to pay it. It is far more likely, however, that the bill will be accepted by one of the great *acceptance houses* which perform this service for their clients for a small charge. Acceptance by one of these houses gives the bill better standing than does acceptance by most importers. In all the important exchange markets, such as London, New York, and Paris, there are in ordinary times hundreds of millions of dollars' worth of such bills created by exporters. Bills of exchange are used not only in payment for exports, but in settlement of many other kinds of international obligations, as we shall see. We shall first consider their use, in the form of commercial bills, in paying for exports of goods.

Payment of a bill of exchange. The bill of exchange which the American exporter draws or has his banker draw for him calls for payment in British pounds in England; but the

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[1] Albert L. Myers, *Elements of Modern Economics*, rev. ed., p. 358.

American exporter wants dollars in America, and therefore the British pounds must be exchanged for dollars before he is finally paid. How is this exchange to be managed? The exporter might, of course, have the bank to which the British importer makes payment exchange the pounds for gold dollars or gold bullion, and send the dollars or bullion to him. Or he might conceivably ask the British importer or his bank to send over British gold pounds, which he could exchange in New York for United States currency. He might do either of these, but it would be most extraordinary, for shipment of gold is expensive, and it would take some time to settle the obligation in this way.

In New York City there is also, let us say, an importer of British goods who must make payment in pounds to the British exporter of the goods. Like the American exporter, but in reverse, he could buy British gold pounds in New York and send them across, or he might send over gold dollars or gold bullion to be exchanged for pounds; but obviously it would cause unnecessary trouble and expense to have American importers sending gold to England and British importers sending gold to America.

The balancing of export and import payments. There is a better and cheaper way to settle these two obligations. The American importer simply buys the bill created by the American exporter from the bank or broker who holds it; and in London the British importer buys the exporter's bill. In this way the American exporter gets his money in dollars from the American importer, and the British exporter gets his money in pounds from the British importer. If the export and import represent equal values, the payment involves no shipment of gold, no delay, and only the small expense of the banker's or broker's commission. We need not follow the bills in all their possible later wanderings, except to say that if they are sight bills they are probably paid and canceled in New York or London; time bills may be bought by a bank and held to maturity.

The exporters, or their bankers, draw the bills, and the importers buy them. In other words, the exporters provide the supply of bills, which means the supply of foreign moneys, because these bills call for payment in foreign moneys; and since these foreign moneys must be exchanged for dollars to make payment to the exporters, exports result in a demand for dollars, or for *dollar exchange,* that is, bills of exchange drawn by European exporters against American importers, payable of course in dollars. On the other hand, imports provide the demand for the bills drawn by American exporters. These bills, it will be remembered, are payable in foreign moneys and in foreign countries, and therefore provide the importers with the foreign moneys they need to pay for imported goods. In the national balance sheet, the exports are credits to the United States, because they call for payments to us in dollars; and the imports are debits on our ledger, because they call for payments by us to exporters in foreign countries.

"Invisible items" in exchange. Exports and imports of *goods* are not the only items that enter into our national balance sheet. As in domestic trade, services, debt and interest payments, loans, and various kinds of financial transactions—"invisible" exports and imports—must also be included. On the credit side of our ledger we include everything that calls for payment to the United States in dollars, such as debt and interest payments to our government or to private investors here. When the Finnish government, for instance, paid its debt to the United States, it bought American exchange, payable in dollars, to send to our government. Americans have some 13 billion dollars invested in various parts of the world, and the payment of interest and dividends on these investments calls for the purchase of American exchange, dollar exchange, payable in dollars. When Europeans invest funds in the United States in stocks, bonds, or tangible property, they buy United States exchange, payable in dollars. At one time, more than a million immigrants entered the United States each year, and each one was required to bring $25 in with him; this requirement was met by the purchase of American dollars. Although foreigners have never been so addicted to touring as we have, some do come to the United States, and they buy American dollar exchange to use while here. There are also other small items which need not be mentioned here.

The debit side of our ledger likewise includes, in addition to our imports of goods, "invisible" items which call for the purchase of foreign moneys, ordinarily through the purchase of bills of exchange drawn in the United States against foreigners and payable in foreign moneys—foreign bills. American tourists used to spend hundreds of millions of dollars abroad every year; and to pay their expenses they bought travelers' checks or American Express checks, which are based on foreign bills and payable in foreign moneys. Payments to the foreign shipping companies that formerly handled much of the shipping for American importers and exporters created a demand for foreign bills, foreign moneys. The foreigners who live in the United States and send funds to their relatives abroad buy foreign bills for this purpose. Americans who make charitable contributions to foreign organizations also buy foreign bills, foreign exchange. American corporations pay interest and dividends to foreign investors in American money ordinarily, and the foreign investors then convert the dollars into their own money. Americans who invest money or make loans abroad buy foreign bills. At one time London banks did most of the international banking and received payment for this service either through the creation of bills in London or, what amounts to the same thing in the exchange balance, through the purchase of foreign bills in New York.

BALANCE OF INTERNATIONAL PAYMENTS OF THE UNITED STATES, 1939
(In millions of dollars)

Item	Receipts from Foreigners for "Exports" (Credits)	Payments to Foreigners for "Imports" (Debits)	Net Credits (+) or Debits (−)
Trade and service items:			
Merchandise. ..	$3177	$2318	$+859
Merchandise adjustments	64	44	+20
Freight and shipping	125	249	−124
Travel expenditures	170	469	−299
Personal remittances..	45	144	−99
Institutional contributions....	.	43	−43
Interest and dividends	531	211	+320
Government transactions...	32	96	−64
Miscellaneous services	147	59	+88
Total trade and service items. .	4291	3633	+658
Gold and silver:			
Gold exports and imports .	1	3575	−3574
Gold earmarking operations (net).......		..	+534
Gold movements (net) .	. .	....	−3040
Silver exports and imports......... . .	14	85	−71
Total gold and silver movements (net)	. .	. .	−3111
Capital items:			
Long-term capital movements.......	1624	1510	+114
Movement of short-term banking funds (net).. . . .	....	....	+1116
Miscellaneous capital items (net).........	....	..	+69
Paper currency movements (net).........	. ..	. .	+117
Total capital items (net)............	....	....	+1416
Other transactions and residual.....	....	....	+1037

The balance of international payments. Each year our government publishes figures showing the balance of international payments. The accompanying balance sheet for 1939, a prewar year, is worth studying. The first column of figures represents credits to the United States, transactions which call for payment to us and result in a demand for American dollars. The second column lists credits to foreign countries (debits to us), transactions which call for payment to them and result in a demand for foreign moneys. Gold and silver exports and imports have much the same significance as exports and imports of any other kind of merchandise. They help to make up the balance of international payments. The capital items represent short-term loans, long-term loans, investments in securities, and other similar transactions which need not be discussed in detail here.

Mechanism determining the rate of exchange

In analyzing the mechanism which determines the rate of exchange, that is, the rate at which the money of one country exchanges for that of another, we are obliged to begin by describing it as if it were still operating, a process which in most countries in very recent years has given way to government fixing of the rate. We must do this not only because of the historical significance of the analysis, but because the factors which formerly determined the rate in a free market are still at work, somewhat as in the goods markets the forces which determine prices continued to operate even after the OPA set prices for many things.

Like any other price, the rate of exchange, if there is no government interference, is the result of the interaction of demand and supply, the demand for dollars being determined by the exporters and others who draw bills and offer them for dollars, and the supply of dollars being determined by the importers and others who offer dollars for foreign bills.[2]

If the demand for and the supply of bills, and therefore the demand for and the supply of dollars, are equal, the rate of exchange with any country will be at *par*. The term par expresses the relative amounts of gold in the moneys of any two countries, both of which are on a gold standard. Before the devaluation of our gold dollar, for instance, the gold in the British pound sterling contained as much gold as $4.86 in American money, and this ratio was therefore par between Great Britain and the United States. Since this par prevailed during most of the years when both these countries were on a gold basis and before foreign exchange was disrupted by war, we shall use it as if it still prevailed, taking up the present par later in our discussion.

Suppose now that the supply of bills created by American exporters exceeds the demand on the part of American importers. There will be more bills than the importers want to buy, and their price will decline. In terms of British and American moneys, this means that there is an excess demand for American dollars with which to pay our exporters. American dollars will therefore rise in terms of British pounds, and the rate of exchange may decline, let us say, to $4.84. Or, to look at this from the British side, if London importers are importing more goods than London exporters are exporting—the British view of an excess of exports from the United States—there will be an excess demand in London for dollars with which to make payments, and the price of dollars will rise in terms of British pounds; that is, the pound will buy fewer dollars—say $4.84. However, since it will be confusing to the student to shift back and forth from New York to London, we shall discuss exchange from the New York point of view.

Limitations on exchange rate fluctuations

How far can the exchange rate decline? The limit is set by the cost of shipping gold, which before the First World War was about two cents per British pound sterling. That is, American exporters, with their oversupply of bills, could afford to sell these bills at a discount of as much as two cents, or $4.84; but rather than accept less, they would call upon the British importers to send gold in payment. Thus 4.84 was the *gold-importing point* below which the price of bills could not go as long as gold was available for shipment.

Turning now to the reverse situation, suppose that the demand for bills exceeds the supply. In this case the price of bills will rise. Because there will be an excess demand for British pounds with which to pay London exporters, the price of pounds, in terms of American dollars, will increase. A pound will buy more American dollars, which means that the exchange rate will rise above $4.86, say to $4.88, or two cents above par. New York importers will pay this much for bills with which to settle their accounts; but if the rate rises above this point, they will ship gold to England in payment of their accounts. This figure, 4.88, was the *gold-exporting point,* the upper limit to the rate of exchange as long as gold was available for shipment.

A mere excess of merchandise exports does not necessarily bring the rate of exchange down to the gold-importing point, nor does an excess of imports necessarily raise it to the gold-exporting point. As we have already seen, invisible exports and imports play as important a part as the visible exports and imports. Furthermore, there are always speculators in the exchange markets who may buy bills at a little above or below par, hoping for a later fall or rise in the rate. Relative interest rates on time bills in the different markets may also play a part in determining exchange rates. If, for instance, exports exceed imports and the supply of bills is in excess of the demand in New York, dollar exchange ordinarily will be at a premium; but if interest rates are higher in London than in New York, time bills, drawn on London in pounds, may nevertheless be at a premium because of the demand for pounds to invest in London at this high rate of interest. International loans, rather than gold shipments, are often employed in the settlement of unbalanced trade for a limited time. A loan by a New York bank to a London bank has the same immediate effect on the rate of exchange as an import of goods, for it involves a demand for sterling exchange, or pounds, because it calls for payment to be made to London. When the loan is repaid, this situation is reversed.

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[2] Graham suggests that we have here not sale but barter, that "'buying' and 'selling' are terms strictly appropriate only to transactions involving money and credit on the one side, and goods and services on the other," that "they are not so appropriate to exchanges of goods for goods, or to money and credit for money and credit." He is of course correct about this, but the underlying forces in exchange seem analogous to supply and demand; and since throughout this book we stress supply and demand as the forces determining price, we do so here. See Walter E. Spahr and others, *Economic Principles and Problems,* 4th ed., chap. 25.

The balance of one country against all other countries

This presentation is far too simple, however; we must complicate the problem slightly in order to bring it nearer reality. The balance of trade and exchange is not between the United States and any one country, but between the United States and all other countries. Much of the trade of the world is triangular, quadrangular, or even more "angular." The United States, for instance, has for years had an excess of exports in her trade with Great Britain; Great Britain has maintained an excess of exports in her trade with Brazil; and Brazil in turn exports to the United States much more than she imports from us. In this case our excess of exports to Great Britain pays for our excess of imports from Brazil. Since we do not export enough to Brazil to balance our imports, we pay for part of our imports with our excess of bills drawn on Great Britain; Brazil pays for part of her excess of imports from Great Britain with her excess of bills drawn on the United States; and Great Britain uses part of her excess bills drawn on Brazil to pay for her excess of imports from the United States. This, roughly, is the process employed, the adjustment of payments being made by banks and bill brokers in all three countries, and to some extent in other exchange markets. At one time most of the international trading in bills was done in London, but in recent years an increasing amount of it has been handled in New York.

Rates of exchange between any two countries must be about the same in all the important exchange markets because of *arbitrage* operations, that is, the buying and selling of different moneys in the various world markets. If, for instance, the pound-dollar exchange rate reached \$4.90 in New York and \$4.80 in London, arbitrage operators could buy dollars with pounds in New York, receiving \$4.90 for each pound, and buy pounds with dollars in London, receiving a pound for only \$4.80 and making 10 cents on each pound, less the small cost of the transaction. They would continue this until they brought the rate to approximate equality in the two markets.

Necessity of a balance between exports and imports

It is one of the fundamental principles of foreign trade that in the long run imports must equal exports, and trade must balance. Let us see how this is brought about. We shall assume that the United States has an excess of exports, visible and invisible, for a number of years, with bills of exchange selling at the gold-importing point and gold flowing here in payment for some of these exports. If this movement of gold continues long enough and in sufficient volume, and if the gold is used as money both in the countries from which it comes and here, the effect of the gold movement will be to raise prices in the United States and to lower them in the other countries, according to the quantity theory of money. This will make it less and less profitable to buy goods in the United States, where prices are rising, and our exports will decline; on the other hand, the countries from which the gold came will have falling prices which will make it more profitable to buy goods there, and more goods will be imported into the United States from those countries. Thus, gold movements will force exports and imports into equilibrium.

A word of caution is necessary here, however. An excess of visible exports does not necessarily mean unbalanced trade. For more than half a century, from 1873 to the beginning of the First World War, England enjoyed a large excess of imports of goods. This did not mean that her trade was unbalanced, but that the foreign countries in which British capitalists had invested during the preceding century or more were paying the interest on those investments in goods. The United States usually had an unfavorable balance of trade prior to 1873, which represented investments by European capitalists, largely British, in American enterprises and resources; but from 1873 to 1914 we exported an excess of several hundred million dollars' worth of goods annually—interest, in goods, on the debt owed to European investors. In reality, this history of trade balances is proof of the fact that trade must balance in the long run. Our excess of exports after 1873 represented the balancing of our excess of imports before then; similarly, Britain's excess of imports after 1873 represented interest, in goods, on the investments of British capitalists before 1873.

Devaluation of money by one country

Suppose that one of two countries on the gold standard devalues its gold money, reduces the size of it, as the United States did early in President Roosevelt's first administration. It will be recalled that in 1933 the (theoretical) size of the gold dollar was reduced about 40 per cent by increasing the mint price of gold from $20.67 per ounce to $35. At first our government abandoned the gold standard entirely, but later it returned to a hybrid, hypothetical gold standard by agreeing to buy and sell the metal at the new price. As we have seen, the motive behind this was the desire to raise prices, the assumption being that an increase in the number of dollars would have this effect, even if the dollars were not used as money. Since we have already considered the effect of devaluation on the price level, we shall here consider the effect on foreign trade and exchange.

If the United States, and other countries as well, had been on a genuine gold standard, the new dollar would have raised the exchange rate rather promptly, and would have stimulated exports and reduced imports, for a time. For instance, if Great Britain had been on the gold standard, the new exchange rate, representing the relative amounts of gold in the pound and in the dollar, would have been one pound to $8.24. This would have stimulated exports because American exporters could have sold their bills at a price close to the new rate. These bills, expressed in pounds, would have exchanged for more dollars than formerly, thus making exporting highly profitable. Importers, on the other hand, paying for British pounds at the new rate of $8.24 per pound, would have found importing generally unprofitable. The new rate would have drained goods out of the United States and attracted gold into it, because a given amount of gold would have been exchanged for no more British pounds than before but for about 70 per cent more dollars.

This stimulus to exports could have lasted only until the outflow of goods and the inflow of gold raised our prices high enough to balance the effects of the new par. When prices rose to a point where $8.24 would buy no more goods in this country than $4.86 would have bought before, exporters would have found their business no more profitable than it was before. The question now arises: When, if ever, would domestic prices have risen to this level? Theoretically, the prices of export goods —wheat and cotton, for instance—might have risen to the new level in one or two or perhaps a few years; but how and when would the new par have affected the prices of domestic goods, goods which do not enter into foreign trade?

The prices of domestic goods would not have been directly affected immediately; but in the long run—in many years or even decades—they presumably might have risen because of the shift of labor and capital from their production to the production of the higher-priced export goods. All this is exceedingly uncertain, however; for in the long run many other factors would enter into the determination of the prices of domestic goods.

But neither the United States nor Great Britain was on a true gold standard when our dollar was devalued, and therefore the results were not what we have described. The rate of exchange rose, but not to $8.24. Prices rose somewhat, but whether this was due to devaluation or to other factors is not clear. Our foreign trade showed little change, but this may have been because the United States, as well as most of the other nations of the world, was in the depths of a severe depression, and because in 1934 a disastrous drought cut agricultural production in the Middle West to the lowest point in years. Our experience with devaluation does not throw much light on the results of that policy.

Devaluation of the currency, usually paper currency, has been resorted to by a number of countries in recent years, with the purpose of stimulating exports. Our own policy was motivated by a desire to raise prices, but when Japan adopted a similar policy her purpose was to stimulate exports in order to get exchange for the purchase of war materials. Devaluation amounts practically to a subsidy on exports, with the people paying part of the cost of the goods that are exported—unintentional generosity of a high order. For the United States, this was effected through the purchase of gold (and silver) from various other countries, for more than it was worth. We were trading useful goods for gold, the gold being accepted in payment at more than it was worth elsewhere in the world. This was of course equivalent to a reduction in the price of the goods exported, the reduction being made good by the government, which passed this cost on to the people in the form of higher taxes.

Dislocated exchange

We have been considering international exchange among countries on a gold standard, or on paper standards in some way related to gold, with gold flowing freely from one country to another in settlement of balances. This analysis not only has historical interest and significance but brings out clearly the operation of principles which are still valid. At the present time, however, practically all countries are on paper standards, in some cases only very loosely related to gold. Trade between countries which have no common monetary standard such as gold or silver is balanced through what Taussig calls *dislocated exchanges.*

The general rule in dislocated exchanges is that the rate of exchange is determined in the long run by the *relative purchasing power* of the currencies of the different countries. If, for instance, with both the United States and France on paper standards, our dollar purchases as much here as 50 francs does in France, the rate of exchange will be $1 for 50 francs; or a franc will be worth two cents. A bill calling for francs and drawn in New York on a French importer will have value only in France and will have only the value represented by its purchasing power in France. Similarly, a bill drawn in Paris on an American importer and calling for American paper dollars has value only in the United States and is worth only what it will buy here. With the demand for and supply of bills in equilibrium, the rate of exchange represents an equalization of the purchasing power of the currencies of the countries. In this respect, dislocated exchanges operate the same as gold exchanges, which also tend to equalize the purchasing power of the currencies of different countries.

Dislocated exchanges lack the common denominator, gold, however, which holds fluctuations in the value of two or more standard currencies within narrow limits. In countries on the gold standard, the rate of exchange could fluctuate only within the narrow limits set by the gold-importing and gold-exporting points, and the flow of gold from one country to another was assumed to hold the price levels of such countries at approximately the same levels, and to keep trade fairly well balanced. But when one or both countries are on a paper standard, this balancing effect of gold is lost, and the rate of exchange may fluctuate widely. Even if gold is still used for the settlement of balances, the rate may fluctuate widely, because the gold which moves from one country to another does not tend to bring the price levels and the export and import balances to equality since it is not used as money. Gold shipments between countries on unrelated paper standards are not essentially different from shipments of other commodities.

Dislocated exchanges lack the stabilizing factor, gold, and they are often subject to erratic speculative influences arising from uncertainty as to the future monetary policies of the various countries. Until recently, nations which went off the gold standard were usually in a precarious economic condition, and dealers in exchange were obliged to speculate more or less as to future developments. In recent years, however, most countries have shifted to paper standards, and if the various countries maintain stable paper currencies for some years, this speculative element will be less important. Nevertheless, whenever international trade and exchange are subject to the shifting winds of politics, exchange dealers must take that fact into account and speculate on political developments within the various countries.

Foreign trade and exchange in totalitarian countries

The foreign exchange thus far discussed has been largely free of government interference, except that involved in the regulation of currencies; but here, as in most economic activities, the government is intervening more and more. In totalitarian countries there is little left of the old automatic exchange, for the dictators imposed drastic regulations designed to facilitate the import of war materials and to aid the general plan of conquest. German importers had to secure government permits for all imports, and the German government often used blocked marks in its trade with foreign countries, a device which provided that imports to Germany must be paid for in certain specified German goods. According to this scheme, a German importer of wheat from Bulgaria was not permitted to make payment by buying Bulgarian exchange or exchange on any other country, but had to deposit the amount he owed in the Reichsbank; the Bulgarian exporter, or the person to whom he transferred his claim, could draw on it only to buy German goods, specified by the government. Since the only goods released were those not needed in war and since very high prices were demanded, the Bulgarian exporter was unlikely to thrive excessively by the transaction, but the German government did well. Douglas Miller would have been more accurate if, instead of saying: "You can't do business with Hitler," he had put it: "You can do business with Germany, but you'll lose your shirt if you do."

Exchange stabilization in democratic countries

Even the democratic nations have intervened more and more in international exchange, some of them going so far as to maintain certain exchange rates regardless of the balance of payments. The United States, Great Britain, and a number of other countries have set up large stabilization funds which are used to stabilize exchange rates. If, for instance, there is insufficient demand for British pounds and they begin to decline in relation to American dollars, our Treasury officials in charge of this fund may buy British exchange; and if the dollar begins to drop, they may buy dollar exchange to restore parity. These stabilization operations are carried on secretly to prevent speculators from taking advantage of the government's activities; and the American and British officials work in close harmony to keep the exchange rate as stable as possible.

Such operations have been fairly successful in ironing out short-run speculative fluctuations; but it is doubtful whether they will be able to prevent long-run shifts arising from changes in fundamental trade conditions. It is even doubtful whether it would be wise to do this. Changes in the exchange rate, as we have seen, are the automatic means of bringing trade to balance; and if the stabilization authorities tried to prevent long-run fluctuations in the rate, they would be obliged also to regulate the amount of exports and imports.

There is a strong probability that the governments of almost all countries will increase their control over international exchange. That seems to be the irresistible drift in all economic policies. It is to be hoped that they will expand their controls, not in a selfish scramble by separate competing countries for illusory national advantage, but in a cooperative effort to resolve some of the economic difficulties that must be resolved if there is to be a firm foundation for world peace.

QUESTIONS

1. What are some of the economic differences among nations that give rise to international trade? Which of these differences are likely to persist indefinitely?
2. "The relative advantage of different countries in the production of different goods may be

either absolute or comparative." Explain the difference between the two. Why is the trade between the United States and China based largely on *comparative* advantages?

3. Assuming the conditions existing before Great Britain and the United States left the gold standard, with par at \$4.86, what gold movement would follow if the rate of exchange was \$4.84, \$4.88, \$4.90, \$4.80? Why, in each case? When the rate goes as low as \$3.80, what may be assumed as to the movement of gold?
4. If capitalists in the United States invest heavily in British public utilities, what will be the immediate effect on the rate of sterling exchange? What will be the ultimate effect later, if the utilities declare dividends?
5. Why are the rates of exchange about the same in exchange markets throughout the world?
6. A free trader says: "Every time I buy a Japanese silk dress, or a Mexican blanket, or a British razor, I give employment to an American workman, in work that he can do most efficiently." Do you agree? Explain clearly.
7. Why do we not have to fear trade with a nation which has a much lower wage scale than ours, (a) when both countries are on the gold standard, and (b) when neither country uses gold in international settlements?
8. With the United States and France both off the gold standard, and the French franc quoted at 2 cents, what will be the effect on our exports to France if the purchasing power of the franc in France rises? What will be the effect on the rate of exchange, that is, on the value of the franc in terms of dollars?
9. Why does monetary inflation in a country tend to stimulate exports? Is there any gain or loss to the exporting country from such stimulation? Explain.
10. Describe the use of blocked marks by the German government under Hitler.

Chapter 25.

Tariffs

"After each country had found out how easy it was to tax itself rich by way of tariffs, each state of each country taxed itself rich the same way. Then the cities and towns of each state taxed themselves rich by the same way, and finally Mother taxed herself rich by putting a whopping duty on the roasting ears Pa brought home to cook, then Pa voted himself a two hundred per cent duty on the fur coat he bought for Ma's birthday, and——

" 'G'wan, that's too silly for anything.'

" 'Oh no! It's the economic philosophy of the two historic parties that govern this great and intelligent nation.' "

—Oscar Ameringer

On the problem of foreign trade and protection there is perhaps more rattlebrained thinking, or pretense of thinking, than on any other important economic question. It apparently is one question on which most Americans, and other peoples too, can be relied on to come consistently to wrong conclusions, declaiming sonorous nonsense about "keeping the money at home," "protecting American labor from the pauper labor of Europe," and "planting the factory down by the farm." Our faith in protection is much more a religion than an economic belief; indeed it is generally held more stubbornly than most religious tenets. Economists have properly devoted considerable attention to international trade and tariffs since long before the time of Adam Smith, and as a result of their studies they have been almost unanimously hostile to protective tariffs; yet the general public, in the United States and in most other countries as well, appears to be as strongly protectionist as ever. Although hundreds of books and thousands of articles have exposed the fallacies in most of the protectionist reasoning, the bankers and merchants and farmers go to the polls at every election and vote cheerfully for the "American system" which has brought us such wondrous prosperity. All of which is discouraging.

Advantages of trade

The argument against protection may well begin with a review of the advantages of trade, domestic and international. Just as the total production of our economy is enlarged by occupational division of labor into carpenters, plumbers, farmers, electricians, and so on; just as the output of goods is enlarged by regional specialization—Kansas growing wheat, California producing oranges, Texas raising cotton —and by the exchange of goods among the different regions within a country; so does international specialization and free exchange of goods enable the world to produce more than it otherwise could. Free exchange of goods enables each country to devote its capital and labor to the production of the commodities in which it has the greatest comparative advantage, and so provides the maximum output for all. The policy of protection tends to deprive the people of all countries of the advantages of international specialization, and to reduce production and lower the standard of living everywhere. That is the general effect, just as surely as the standard of living in the United States would be lowered if trade among individuals were restricted and every man had to raise his own food, make his own shoes and clothing, and build his own home; just as surely as it would be reduced if interstate trade were prohibited and Kansas people could no longer buy California oranges and Michigan automobiles, and Rhode Island people could no longer buy Kansas wheat, Texas gasoline, and Pittsburgh steel.

The principle involved may be illustrated by imagining what would happen if the United States were to shut out all imported products that could possibly be produced at home. Many of the things we commonly enjoy would be so expensive and scarce that few could have them. Bananas could perhaps be grown in Florida at very high cost; coffee might conceivably be grown in hothouses, but the supply would be so limited that only the rich could buy it; linen and silk could be produced, but at much higher cost than when imported; rubber substitutes are now being produced, but they are expensive and inferior to the imported natural rubber.

Suppose now that Kansas were to embark on a tariff program and to try to achieve self-sufficiency. She could produce a little cotton at high cost, but cotton clothes would be a luxury; by devoting more of her land to forests and using her own scanty and generally inferior lumber, she could build wooden houses, but they would be expensive and necessarily small; she could build some manufacturing plants, but except in flour milling and meat packing the small home market would permit only small plants, which would necessarily produce at high cost. Altogether, it is clear that her people would have to live rather primitive lives under such a program and that the state could support only a small proportion of her present population. Absolute prohibition of imports by a state like Kansas, or by any other state, would force the people to a life closely resembling barbarism.

It is thus apparent that protection, viewed broadly, is designed to reduce the amount of international trade and specialization, and so reduce the productivity of labor and the amount of goods available for consumers. Since under free trade labor and capital would seek those channels of production in which they were relatively most efficient, in which they would need no protection, it is clear that the demand for protection must come generally from the inefficient industries, those which cannot meet foreign competition. These are essentially "pauper" industries, asking for tariff "alms" in the form of high prices exacted from the people, to enable them to engage in lines of production in which they cannot support themselves. Most of those who damn the New Dealers for their generous relief policy do not realize that the first great relief program was the system of protection.

Why we have tariffs

It might seem that people would be eager to have as abundant supplies of goods as possible, and would therefore be unwilling to subject themselves to deprivation in this way. Why do they do it so patriotically and cheerfully? It is rather hard to explain; but, as Taussig has pointed out, one reason may be that "perhaps the ancient association of foreigner with enemy still lingers."[1] Trading with our own people is one thing; trading with the people across the border is something else. The protectionist creed, moreover, is one aspect of our general preference for producer over consumer. Producers are often well organized, with well-established propaganda organs and great political influence; whereas consumers are almost completely unorganized and frequently are ignorant of their own interests, partly because producing interests find it profitable to keep them in this state. The protected interests have been able to build up a line of specious arguments and slogans and war cries too subtle for consumers to see through. Not infrequently, they have succeeded in mixing with their economic appeal enough nationalistic and patriotic jingoism to blanket whatever rational discernment consumers might have. Recruiting dupes for the protectionist program involves somewhat the same type of campaign as recruiting soldiers for war. "Protect the American Standard of Living," "American Markets for Americans"—such patriotic appeals do make the spine tingle!

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[1] F. W. Taussig, *Principles of Economics*, 4th ed., vol. i, p. 510.

Another reason for the widespread prevalence of the protectionist bacillus may be the fact that people so generally confuse money with wealth and want to shut out imports in order to maintain a favorable balance of trade, on the theory that gold will then flow into and enrich the country. This overemphasis of money goes back to the mercantilists. In 1663 Samuel Fortrey, gravely concerned as to ways in which "the plenty of money be increased amongst us," figured that English imports from France were £1600 greater than her exports to France, and that this amount was "clear lost to this kingdom." Thomas Munn (1664) similarly believed that foreign trade was "the ordinary means . . . to increase our wealth and treasure," and that the English must observe the rule "to sell more to strangers yearly than we consume of theirs in value"; yet Munn was opposed to many of the mercantilist policies.

False conception of a "market"

One of the stupidest notions widely held regarding foreign trade is that there is a great gain in finding "foreign markets." It is commonly assumed that foreign trade would be a fine business if we could just get rid of some of our goods in foreign markets without receiving anything in exchange, without accepting any imports. What would we think of a farmer who brought his eggs and butter to the store in town but refused to take any other goods in exchange? On a national scale, that is what Americans have long tried to do. Actually, exports are so much loss to the country, for they are valuable only as a means of securing foreign goods; yet most Americans, and other peoples as well, seem to have a deeply ingrained hostility to imports, seem to wish that they could carry on foreign trade at a total net loss of all the goods they export. This was shown clearly after the First World War. During that war and for a few years afterward, the United States exported tremendous quantities of goods to Europe and built up billions of dollars in credit balances there. This was apparently entirely satisfactory to us, for it was a way to get rid of goods; but when the Europeans tried to pay back in goods, there was a great outcry and the tariff was promptly raised. The idea seemed to be that goods, European goods, were not good for us. Having paid for these goods by heavy exports in previous years, we could have taken all that Europe would send with no further cost to us, as free as manna from heaven, but we did not want her goods. The people of Galilee were wiser—they ate the manna and liked it.

Dudley North on trade

The falsity of this notion of the gain to be derived from a favorable balance of trade has scarcely ever been demonstrated by modern economists better than it was by Sir Dudley North in 1691:

> It is not long since there was a great noise with Inquiries into the Balance of Exportation and Importation; and so into the Balance of Trade, as they called it. For it was fancyed that if we brought more Commodities in, than we carried out, we were in the High-way to Ruin. . . . And now we complain for want of Money in specie, that Bullion is exported or mis-employed to other uses, than making Money; and ascribe the deadness of Trade, Especially of Corn, and Cattel in the Country, to this. . . .
>
> Now it may appear strange to hear it said,
>
> That the whole World as to Trade, is but as one Nation or People, and therein Nations are as Persons.
>
> That the loss of a trade with one Nation, is not that only, separately considered, but so much of the Trade of the World rescinded and lost, for all is combined together.
>
> That there can be no Trade unprofitable to the Publick; for if any prove so, men will leave it off; and wherever the Traders thrive, the Publick, of which they are a part, thrives also.
>
> That to force Men to deal in any prescrib'd manner, may profit such as happen to serve them; but the Publick gains not, because it is taking from one Subject, to give to another. . . .
>
> That Money Exported in Trade is an increase to the Wealth of the Nation; but spent in War, and Payments abroad, is so much Impoverishment.
>
> In short, That all favour, to one Trade or Inter-

est against another, is an Abuse, and cuts so much of the Profit from the Publick."[2]

Injustice of the tariff policy

That a tariff, when first imposed, works injustices among the different economic classes is clear, for it has the effect of enhancing profits in the protected industries, while at the same time it reduces the amount of goods and raises prices for those in other kinds of work, and inevitably reduces profits in some other industries. The imposition of a tariff on woolen cloth or a rise in the tariff on it, for instance, tends in the short run to throw unearned gains into the laps of the producers of woolens; but it tends to raise prices to consumers and also to reduce the profits both of clothing manufacturers, who find their costs higher, and of retailers, who must pay more for their goods and who, if they raise their prices to the full amount of the increase, will sell less. A rise in the tariff on steel similarly may raise the profits of steel producers, but it will tend to reduce the profits of railroads and other consumers of steel, which of course includes a large number of industries. Our tariff on aluminum has cost American consumers many millions and has doubtless increased costs and reduced profits in a number of other industries that use this metal as a raw material.

Tariff gains enjoyed by few people

Only a small percentage of the total population can possibly gain from a protection policy. The several million people who work in the retail and wholesale trade must lose, because the tariff reduces the amount of goods and raises prices, and therefore reduces the volume of sales. Professional and semi-professional workers—doctors, lawyers, preachers, teachers, dentists, barbers—can only lose, through scarcity and high prices of goods. Workmen in unprotected industries—building craftsmen, truckers, mechanics, day laborers, government employees, public utility employees, including the railroads—all these inevitably lose by protection. The railroads lose more than most other industries, because tariffs reduce the amount of traffic between the seaboard and the interior; and railroad employees lose in two ways: in reduced opportunities for employment and in the higher cost of living. Farmers producing wheat and cotton and other export crops obviously gain nothing. On the contrary, they inevitably suffer in two ways: from the reduction in the foreign market and from the higher cost of the things they buy. At the most, less than 10 per cent of the people in most communities can gain from protection, even in the short run. At best, such a tariff policy can be only a burden on at least 90 per cent of the people, for the benefit of the favored 10 per cent. And the gain, even for this small percentage, largely disappears in the long run. The only individuals who gain in the long run are the owners or stockholders of *monopolized* protected industries; even the laborers in these industries must lose, because in the long run they cannot receive more pay than laborers in other industries, and the general level of real wages is reduced by a tariff.

The tariff and profits in the long run

In the long run, protection does not have the effect of raising the rate of profits, even in protected industries unless they are monopolized. High tariff duties on woolen cloth, for instance, did raise the profits of the manufacturers at first, but capital and labor eventually flowed into the industry and brought the profits down to the average. As a matter of fact, a general policy of protection probably *reduces* the profits of all competitive industries, *including those protected,* because it reduces production and wealth, and because the protected industries, if competitive or even monopolistically competitive, cannot maintain profits higher than the average prevailing in the economy. Even more clearly must tariff duties reduce real wages in the long run, in protected as well as unprotected industries, for, as we have seen, they reduce the productivity of labor, and wages can be no higher generally in protected than in unprotected industries. Wages in competitive industries tend to equal marginal productivity, as we shall see, and any scheme which reduces productivity reduces wages.

Tariffs for farmers

Protection of farmers merits special consideration. Tariff duties on wheat, corn, pork, and beef are commonly imposed as a sort of pap to secure the farmers' support of a general scheme of protection, and the farmers usually lap it up and cry for more. They are often cited as the one economic class that, on the question of protection, rather consistently votes against its own interests. Perhaps no other group has suffered so much from protection; yet most farmers—at any rate those in the North and West—cheer and throw their hats in the air whenever they hear the hoary arguments for the "home market" and for the protection of the farm market from avalanches of Mexican cattle, Argentine beef, Canadian wheat, and Chinese eggs. The slave-owning cotton planters of pre-Civil War days knew that high tariffs would be ruinous to them, but for some reason most farmers of today do not see this.

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[2] Sir Dudley North, *Discourses Upon Trade.*

High tariffs on other things than farm products of course injure most farmers, particularly producers of the staple export crops, wheat and cotton, in two ways. In the first place they raise the prices of many things that farmers have to buy—lumber, steel, leather, woolens, and hundreds of others—and in the second place they reduce the foreign market for farm products. Trade must balance in the long run, imports must equal exports, and tariff duties which reduce imports must also reduce exports. Therefore the import duties on manufactured products reduce the foreign market for wheat and cotton, as for all export goods, and the wheat and cotton farmers find their foreign markets dwindling because of the tariff on commodities that the rest of the world would like to exchange for their wheat and cotton. It is often argued that these tariff duties bring new industries into the country and enlarge the home market so that the farmer has as good a market as the foreign market would be; but the home market is not enlarged. The tariff has the effect only of diverting capital and labor from more productive to less productive industries, reducing productivity and wealth, and so reducing the market for wheat and cotton. The tariff on woolen cloth has not increased the total amount of industrial wealth in the United States; it has only diverted labor and capital from more productive industries to woolen manufacturing. A general policy of protection has the effect of reducing imports, and therefore necessarily reducing exports in equal measure, and so it tends to slow down the growth of the industries that offer the greatest international advantages—the export industries, such as wheat and cotton production and automobile and farm implement manufacturing.

The case is somewhat different for farmers who produce mainly for the domestic market and sell little abroad, and for those who produce less than enough for the home market. If there are any net exports, the tariff will be generally ineffective; and if there are net imports, it will presumably raise the price of the farmers' produce, at the expense of urban consumers. The farmers may gain something from the higher price for their products in the short run; but against this must be balanced the loss from higher prices on what they buy, for they are not the only ones protected—the tariff gravy is passed around. The reciprocal trade agreement with Canada adopted by Secretary Hull permitted increased imports of Canadian dairy products, doubtless to the injury of the Wisconsin dairymen in the short run; but in the long run even the Wisconsin dairymen will probably gain from the general reduction in tariffs.

But what of the "home market" for farm products? Protectionists argue that it is fine statecraft to put a heavy duty on foreign manufactured products and build up home industries. The trouble with the home market is that it is not as good as the foreign market; that is, the farmer gets less from it than he would from the foreign market. The tariff must raise the prices of manufactured goods or it will not be effective in promoting home industries, and the farmer must pay these higher prices without getting any more for his own produce. To put it in another way, he must exchange his products for less than he could have got in the foreign market. The home market is maintained by tariff alms paid by the farmer and by consumers in general.

Tariffs and the development of industries

It would be erroneous to think of a tariff as merely determining whether there shall or shall not be a given industry in a country. It is usually a question not of whether or not but, as so often in economics, of more or less. Without any protection at all, the United States would have a woolen industry and a silk industry, almost all the industries she now has, and Germany and Japan would produce farm crops. The effect of protection is merely to increase the amount of capital and labor used in the protected industries, relative to the amount used in the more efficient export industries. In such countries as Germany and Japan, a protective tariff raises prices of farm products and brings more intensive cultivation of the land and higher rents; if there were no such tariff the land would of course be used, but less intensively.

Tariffs and the amount of employment

Probably no other argument for protection is used as much as the claim that it increases the amount of employment. People see imported goods sold in the stores, perhaps at a time when there is widespread unemployment, and jump to the conclusion that our unemployed could have jobs if these goods were made by American labor. They assume that the trinkets imported from China and Czechoslovakia which they see in the Woolworth stores have taken jobs that should have been given to home labor. This argument is entirely without validity. Exports must equal imports in the long run, and therefore American labor has to produce the goods that are exchanged for the imported trinkets. If we shut out these goods in order to give our workmen jobs making these articles, we thereby take jobs away from the producers of the cotton, pork, automobiles, and farm implements that would have been exchanged for the imported goods. There would be no increase in employment, but only a shift from products in which we have a comparative advantage to others in which we have no such advantage, with a reduction in our supply of goods and a decline in our standard of living. A protective tariff can no more increase employment than can a decline in the efficiency of labor from any other cause—malaria, hookworm, pernicious anemia, or widespread drunkenness.

Protection against low wages abroad

On a par with the employment argument is the argument that the highly paid labor of the United States must be protected against lower-paid foreign labor, rather generally referred to as the "pauper labor of Europe." Many people believe that the tariff is responsible for our high level of wages, but this is quite as absurd as believing that wages can be raised by the spread of malaria or hookworm. The tariff—we may well reiterate this fundamental truth—diverts productive resources from those industries in which we have a greater comparative advantage to those in which we have less or no such advantage, from those industries in which our labor is comparatively effective to those in which it is comparatively ineffective; and therefore it reduces the total economic output which constitutes the real wages of any country. As Keynes once said: "A tariff can do nothing that an earthquake could not do quite as well"; it can only reduce wealth and income, just as an earthquake does. The high wages paid in the United States are due to the high productivity of labor here, which the tariff reduces.[8]

There is no basis for the common belief that a country with high wages cannot trade advantageously with one in which wages are low, any more than there would be for the notion that a rich man cannot deal safely with a poor man. A rich man can safely buy melons and carrots from a poor truck gardener or hire the services of a maid or stenographer. He not only runs no risk of lowering his standard of living, he raises it; for if he had to grow his own melons and cook his own meals he would have to live a rather simple life. He may even rejoice, as perhaps he does, that there are some poor people with whom he can deal so advantageously, for he can trade the income from an hour of his own labor for a day's work by the truck gardener or maid. So likewise can Americans trade the product of an hour's work, in the form of wheat or cotton or steel, for the product of several hours of work by a Chinese workman, in the form of toys or embroidered silks.

But is there no danger that China with her cheap yet efficient labor may underbid our workmen in many fields of industry and flood this country with cheap goods? Certainly not. In the first place, low wages in China do not necessarily mean low costs of goods there, and high wages in the United States do not mean high costs here. Prices are not generally lower in countries with low wages than they are in the United States. Such things as handmade goods, novelties, and some manufactured goods are cheaper; but others, such as lumber, automobiles, heavy steel manufactures, and many food products, may be very expensive. It is the efficiency of the American economy that makes wages high. Iowa farmers produce so much pork per man that even with pork prices low they make high incomes; American steel workers, at the highest wages paid in steel plants anywhere in the world, make steel about as cheaply as the workers of any other country. Our automobile workers are paid high wages, high even in the American scale; but automobiles are cheaper here than anywhere else. There is no reason to assume that the low wages of foreign labor will enable those countries to swamp us with all sorts of goods, although foreign producers will of course have to produce *some* things more cheaply if there is to be any trade.

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[8] Keynes, almost alone among well-known economists, has recently come around to something of a protectionist attitude, but he views the problem only from the short-run point of view.

In the second place, as we have seen, trade must balance in the long run, and hence heavy imports will have to be balanced by heavy exports. Free trade would therefore increase foreign trade, both imports and exports. There would be no decrease in employment in any country, but only more goods.

The "scientific principle" of tariff making

As a defense against possible floods of cheap goods made by low-paid foreign labor, protectionists some years ago stumbled upon the "scientific principle" of tariff protection, according to which the tariff duty imposed should just equal the difference between the domestic and the foreign costs of production. The theory was that such a tariff would make it possible for American manufacturers to compete on even terms with foreign producers who paid lower wages. Unfortunately, however, the scientific principle was based on ignorance of the principles governing foreign trade.

In the first place, there was an implied assumption that costs are generally lower abroad, which is not true. In the second place, the advocates of the scientific principle apparently failed to see that a tariff which equalized costs here and abroad would shut out all imports—obviously importers can make no profits importing goods which they can buy as cheaply at home. The equalization of manufacturing costs would leave American producers the protection represented by the cost of shipping. Applied consistently, the scientific principle would of course bar all goods, even those which we produce only at very great expense. Adam Smith pointed out that "by means of glasses, hotbeds and hot walls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries." Silk and hand-embroidered silk goods now produced in China could be made in the United States at perhaps ten times the cost in China; a 1000 per cent tariff would equalize costs and shut out the Chinese goods, but the American-made goods would be so expensive that there would be little demand for them. How far should we go in applying the scientific principle? Where should we draw the line? Certainly if we applied it in thoroughgoing fashion, we should stop all imports, and therefore all exports as well.

In the third place, the scientific principle rests on the far too simple assumption that there is one level of costs for all foreign manufacturers, and another level for all American producers. Abroad as well as in the United States, there is a considerable range of costs among the producers of almost every commodity, and practically any tariff duty which is not prohibitive will equalize some costs here and abroad. The cost of producing wheat in Wisconsin, for instance, was found to vary from 25 cents to $2.50 a bushel at one time, and its cost in Argentina or Canada doubtless varies similarly, if not quite so much. Manufacturing costs do not vary so widely, but there is considerable range. At any given price, within a certain range, there will be marginal producers who are making just enough to cover costs; and within this range, any tariff, if not entirely prohibitive, will equalize marginal costs.

This becomes even clearer if we consider the general level of costs for all industries and the over-all effect of a schedule of tariff duties covering all or a large proportion of them. Any level of duties will equalize marginal costs, shipping costs included, provided it does not shut out all imports. Indeed, between countries on a gold standard, and in the long run between countries on different standards, the average levels of costs will tend toward equality even with free trade, as they will with any level of duties short of prohibition.

Costs vary among different producers, and they may also vary according to the amount of goods produced. As we have seen, goods may be produced at constant, increasing, or decreasing cost; and, under competition, if they are produced under either of the last two conditions, marginal costs will vary with the output and will be equal to whatever price is established. If the price of wheat is $2 a bushel, the marginal costs will be $2; if the price is $1, less will be produced and the marginal costs will be $1. The scientific principle of equalizing costs is meaningless.

Finally, the scientific principle runs into the difficulty that costs cannot be definitely ascertained, even in the United States, and even more obviously not in foreign countries. It is not difficult to imagine what friendly help foreign producers would give tariff investigators who were trying to determine their costs, and how much tariff protection would be necessary to shut out their goods.

The tariff as a tax

The tariff is not only a means of protecting home producers but a means of raising revenues, a tax. Many protectionists argue that the foreign producers pay the tariff; but while this may conceivably be true in very exceptional circumstances, in general it is the American consumers who pay it and a great deal more. The burden on them varies with conditions and circumstances, shading from one extreme, with the foreign producers paying the tariff and something in addition, to the other extreme, with American consumers paying an amount equal to the tariff and a great deal more, and the government receiving no revenue. The first extreme we cannot consider here because of the difficult theoretical problems involved. It is certainly uncommon or perhaps possible only theoretically.[4] A tight foreign monopoly selling almost all its output in the United States might perhaps be obliged to assume much of the burden of a tariff imposed by the United States, by lowering its prices to get over the tariff wall. The extent to which it would do this would depend not only on the availability of other markets for its product, but on possible sources of supply in other countries or in the United States; on cost conditions of the monopoly—whether increasing constant, or decreasing cost—and on the elasticity of demand in the United States. It is conceivable but hardly possible that the foreign monopoly would lower its prices enough to assume the entire burden of the tariff. The short-run and long-run situations would not be exactly the same.

At the other extreme is the situation in which American consumers pay all the tariff, or more. A tariff on coffee, tea, rubber, silk, or any commodity that is not produced here at all is ordinarily paid by American consumers, but with nothing added. The government receives as revenue all that the consumers pay, and there is no additional cost in capital and labor misdirected into inefficient channels. Great Britain long followed the policy of imposing tariffs only on such goods. When she imposed tariffs on imported goods which were also produced at home, she levied excise duties on the home industries to get the maximum revenues and avoid protection, a logical and consistent policy. When a country seeks customs revenues it should impose "revenue tariffs," with rates so low that goods would continue to be imported, because it is the imports that pay the customs duties. To the extent that a tariff is protective, it must shut out imports, and therefore it can yield no revenues. There is thus a fundamental antithesis between protection and revenues.

A tariff on foreign goods which results in the establishment of a high-cost industry in the United States may impose on consumers a burden far greater, perhaps many times greater, than the amount of the customs duties collected by the government. The tariff on woolen goods is probably of this type. It brings in customs duties of about 6 million dollars, but costs consumers perhaps fifty or a hundred times that amount. Our sugar tariff was estimated to cost consumers 268 millions in 1930, for government revenues of only 115 millions. A tariff greater than the difference between domestic and foreign costs may lead to monopoly, as was the case in the steel and aluminum industries. Finally, a prohibitive tariff yields no customs revenue at all, yet may impose a very high cost on consumers. As a tax, such a tariff is the worst one imaginable, for it yields nothing, but raises prices, in some cases very considerably.

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[4] See John Stuart Mill's classic exposition in his *Principles of Political Economy*, Book III, chap. 18.

Tariffs as taxes are bad in other respects. Since they are not recognized as taxes by most consumers, who are blissfully unconscious of the fact that the high cost of many goods is due to tariffs, they have been used far too much. If in selling protected goods merchants were required to state separately the price, if imported free of duty, and the amount added to the price by the tariff, consumers would at least know how much they are paying to "keep their money at home." Suppose for instance, that a certain grade of clothing had to have a tag with the following information: "Price in England, $20; tariff tax, $15; total, $35." Would not consumers scrutinize tariff schedules more carefully and perhaps keep them within more reasonable bounds?

Tariffs as taxes are also bad because they are "regressive," that is, they bear most heavily on the poor and lower middle classes. A day laborer may buy as much sugar as Henry Ford (he really needs more), but under a sugar tariff he pays as much to the expenses of government as Henry Ford does; this means that, on the basis of his income, the rate he pays is more than a thousand times as high. It is scarcely surprising that some of the "robber barons" of the post-Civil War period piled up great fortunes, when there was no income tax and the federal revenues could be collected from the masses of the people through tariffs.

The tariff on sugar

An illustration of the tariff system at its worst may be seen in the sugar tariff. Here is a tariff which costs sugar consumers two or three times as much as it yields in revenue, for the protection of an industry which yields the farmer producers of cane and beets, as farm income, only about one-third as much as it costs consumers! In 1930, the cost of the sugar duties to consumers was more than the customs revenues plus the total farm income of the farmers who grew the beets and cane. In other words, if we had abolished the sugar tariff, we could have paid in taxes the amount of the customs revenues, could have paid the farmers as a pure bounty all that their crop would have been worth, without requiring them to do any work whatever, and still saved some 50 million dollars—we could have kept all these farmers on relief for much less than the tariff cost. The sugar monopoly is the only group that gains anything from the high duties.[5]

But this is not all. Under the stimulus of the tariff, many farm communities in the West have turned from lines of production in which they were self-supporting to the production of sugar beets, using wretchedly paid Mexican or other foreign labor, children and women as well as men. The work is seasonal, and the total annual earnings are so small that the laborers live in deep poverty, many going on relief in the winter. In such communities, thanks to the sugar tariff, the fine democracy of the one-family farm is changing to an increasingly common form of American feudalism.

The tariff and politics

One of the worst features of the tariff system is the political debauchery that inevitably accompanies the squabble for tariff alms. Many people speak deprecatingly of the "pork barrel" which is usually opened in Congress for deserving members—the funds appropriated for post offices, roads, useless river dredging, free seeds, jobs for the home folk, and the like—but the tariff is the biggest pork barrel of all. Around it, whenever the tariff is under consideration, stand representatives of most of the country's industries, particularly the "pauper" industries, seeking the power to exact tariff alms of consumers, in the form of high prices, in order to maintain themselves in businesses that they cannot carry on efficiently. Here the only interest that should generally be considered, that of the consumers, is not considered at all. The amount of tariff "pork" handed out to the various interests usually depends not on any considerations of the public good, but on the power and shrewdness of representatives of the various interests, on the respective contributions to campaign expenses, and in some cases on personal political connections. Taussig mentions the high tariff on pincers put through for a friend of a former Vice-President, among other similar friendly gestures to good friends. In 1929 someone discovered that a Connecticut Senator had managed to put the assistant to the president of the Manufacturers' Association of Connecticut on the government pay roll; he was to help the Senator draw up a tariff schedule for textiles. Here was lobbying carried on at government expense! If all the undercover manipulation, logrolling, and horse-trading in behalf of protected interests could be known and published, we should have an interesting though depressing story. But wherever there is sugar there will be insects.[6]

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[5] See Lippert S. Ellis, *The Tariff on Sugar.*

A fair picture of the legislative process by which tariff schedules are drawn may be gathered from a letter written by the lobbyist for the National Lumber Manufacturers' Association on April 19, 1909, at the time when the Payne-Aldrich Tariff Bill was under consideration:

> Without going into all the details of the fight at this time, will say that when Mr. Tawney succeeded in getting the rule adopted by the House calling for a separate vote on lumber, we felt reasonably sure of losing the $1. which had been reported by the committee. [The lumbermen had been trying to prevent a separate vote on lumber, so that it would be impossible to hold Congressmen responsible for their vote on this particular item. There was a strong demand for the abolition of the tariff on lumber.] Indeed Mr. Fordney and our other friends in the House, mostly Democrats by the way, gave up hope, and it looked as though an amendment for free rough lumber would carry by three to one. At the suggestions of Representatives Hughes, of West Virginia, Humphreys, of Washington, and Gaines, of [West] Virginia [all lumber-producing states, it should be noted], a caucus was called late Saturday afternoon, the 2nd, and we spent nearly all night rounding up Democrats with whom we could make trades. These covered everything from short-staple cotton and fertilizers to celluloid poker chips and leather-bound bibles, and delivered us 23 votes. We got 18 of the Ohio delegation of 20 on a trade on wool, and this was the stroke that broke Mr. Tawney's faith in humanity, as he counted Ohio as safely within his hands, and has been trying ever since to find out how he lost out. It was a square and open fight, and no tactics were used other than those generally recognized as proper in such cases.[7]

Partly valid arguments for protection

The argument against sudden severe reduction. Whatever may be the advantages of free trade, it must be conceded that sudden severe reductions in tariff rates will cause distress and therefore should not be made unless necessary. Parasitic industries should not be allowed to maintain their hold indefinitely; they should be made to stand on their own feet or drop out, but reasonable time should be given, if possible, to adjust to the lower rates. A distinction might well be made, however, between the inefficient industries which are barely able to operate, even with tariff protection, and those which are highly profitable. Tariff reductions affecting the inefficient industries should be gradual; but some of the highly profitable industries are powerful monopolies, quite able to stand drastic reductions at any time. Most of them should never have been given protection, were never in a position where they could properly ask for it. What would we think if we saw the wealthiest nabobs in town at the relief office, seeking their share of the relief money handed out there? It would scarcely seem the best conduct for aristocrats; but the country's financial aristocrats gather at the tariff relief office whenever a tariff bill is under consideration and demand their share of the relief. It would seem only reasonable that industries seeking protection should make at least a show of poverty.

The tariff and exhaustible raw materials. A partly valid argument for a general policy of protection, yet one which is never used by protectionists, is that it reduces the exports of exhaustible natural resources and so conserves them for our own use. Oil, steel, lumber, copper—these have been important export items; and a general protection policy, by reducing trade of all kinds, may reduce the exports of these resources. Some agricultural exports may well be included here, for in exporting cotton and some other soil-destroying farm crops we are really exporting the fertility of our soil. On the other hand, we also import many exhaustible resources, such as tin and copper and oil, and any reduction in international trade tends to reduce our imports of them and obliges us to produce some of them from our own limited reserves. Particularly destructive in their effects are tariff duties on such exhaustible resources as lumber and oil, for the duties can only hasten the exhaustion of our own supplies. Protection for producers of lumber, oil, coal, copper, steel, and aluminum puts a premium on the destruction of our domestic supplies of these resources and is unwise from every point of view.

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[6] See E. E. Schattschneider, *Politics, Pressures, and the Tariff;* and *The Nation*, March 19, 1930, p. 318, and March 26, 1930, p. 358.

[7] *Report of the Commissioner of Corporations on the Lumber Industry*, 1914, Part IV, p. 65.

The infant industry argument. The infant industry argument runs to the effect that a country, particularly if young, may lack industries, not because it is ill adapted to their establishment but because they cannot be built up in the face of the competition of the well-established industries of other countries, and that a tariff is a protective wall behind which new industries can have an opportunity to get well started and finally become self-supporting. It is assumed that these industries will not need protection indefinitely, and that it will be withdrawn when they are firmly on their feet. This argument was first advanced in the United States in the early part of the nineteenth century and was later used in Germany by Frederick List, who while in America had been influenced by the protectionist doctrines of Alexander Hamilton and by the industrial progress he had seen here. Partly as the result of his influence, Germany embarked on a career of protection and nationalism which she has followed generally ever since.

There is a measure of theoretical validity in the infant industry argument, and there have been examples of success in its application. It is probable that Hamilton's tariff system speeded the development of some of our early industries—at an immediate cost to consumers, of course. The silk industry, which grew up in this country under heavy tariff protection, is now efficient and is probably able to meet most foreign competition on equal terms, although it still demands and receives protection. Prior to 1890, no tin plate was produced in the United States (tin plate is sheets of steel coated with tin, used in making cans); but the McKinley Tariff Act of 1890 extended protection to this industry, and within ten years it had grown large enough to supply practically the entire domestic market and was probably efficient enough to meet the competition of British producers without a tariff. In 1898, however, a monopoly was formed and the price was maintained for some years at the foreign price plus almost the full amount of the duty. Thus protection brought this industry to maturity in less than a decade. The industry then procceded to exploit consumers for another decade, but later the price declined to near the foreign level.

In its practical application today, the infant industry argument offers little that is constructive. For one thing, our Congressmen do not constitute a body of men so qualified and so situated as to be either interested in choosing infant industries that are likely to become self-supporting, or able to do so. Most of these men are interested chiefly in remaining in Congress, which they believe they can do best by getting something for the folks at home, their constituents. Members do not represent the country as a whole, but each represents only a certain section, perhaps with special economic interests which may or may not coincide with the interests of the country as a whole; and Congress is largely an economic "exchange" where representatives of various sections and interests engage in vote-swapping and logrolling and trying to get spoons into the national pap dish, the total effect of which may be mutually self-defeating or generally pernicious, but appears to have an appeal to voting constituents. In considering a tariff, Congressmen are not free to choose the industries that show promise of development; they must demand a tariff on everything their constituents produce. Since every member is doing this and is swapping votes with others to get his share of the tariff pap, protection is ladled out generously. Promising infants are sometimes given protection, for they could hardly escape a tariff that covers nearly everything; but there are also a lot of puling papooses that will have to be wetnursed for the indefinite future, and a great many overgrown infants that should be and perhaps are able to stand on their own feet but who still like pap.

Here is one of the most serious faults in the infant industry argument—protection is usually provided not in proportion to the need for it or the promise of growing under its benefits, but in proportion to the economic and political power of the interests represented in Congress. Powerful interests like the steel and chemical industries, by virtue of the very fact that they are strong and wealthy and therefore presumably not in need of protection, are likely to do well in the tariff scramble because they contribute heavily to the campaign funds of both major political parties. Presidents and Congressmen who have been elected through the generous contributions of such interests do not usually treat their backers with ingratitude. They could not properly do so.

The infant industry argument should not be weighted heavily, finally, because the industries for which a country is economically well adapted are likely to develop without protection, although more slowly. Hamilton's Report on Manufactures indicates that there was a wide diversity of manufacturing industries in the United States as early as 1791. With or without protection, the United States would inevitably have had great steel, copper, oil, aluminum, automobile, tobacco, and cotton industries, almost all the self-sustaining industries we now have; and of course the most efficient industries, the export industries, would presumably be larger. If we lacked the inefficient parasitic industries, those which can operate only with the aid of a tariff, we should be just that much better off.

Protection and national self-sufficiency. One of the most appealing arguments for protection is that it may enable a country to avoid the insecurity inherent in too great dependence on foreign goods and foreign markets. If the entire world were on a secure basis of commercial amity, peace, and good will, international dependence would involve no serious dangers; but in a world of international tension, of wars and rumors of wars, of swift and unpredictable changes in the trade policies of foreign countries, dependence on foreign sources for some essential goods and on foreign markets for surpluses of other goods involves grave dangers. The farmers of Denmark, for instance, worked for many years to build up a fine dairy industry that was heavily dependent on the markets of neighboring countries, particularly England and Germany; and when the world embarked on its crazy course of trade restriction after the First World War, Danish farmers saw their markets partly closed to them, and their dairy business in desperate straits. Japan, through the rapid development of her export industries in recent years, became so heavily dependent on foreign markets for her excess production of silk and manufactured goods that a sharp increase in the tariff schedules of two or three of her best customers—England and the United States, for example—would have been disastrous to her economy. In fact, her precarious trade position, her dependence on imports of raw materials and exports of silk and finished goods, is one reason for her aggressive efforts to gain control of Manchuria, China, and other Asiatic lands.

The quest for self-sufficiency is often partly military in its inspiration. Germany, as part of her war plans, tried in various ways to make herself self-sufficient. Over a long period she tried to build up her food-producing capacity through tariffs on food imports, but the widespread malnutrition and in some cases starvation among her people toward the end of World War I proved that her efforts had not been successful. After that war, however, she adopted an even more rigorous policy of protection and encouraged even more vigorously the development of substitutes for various imported products. France's high duties on food products have not been so definitely military in purpose, but her high tariff on gasoline was calculated to stimulate the production of alcohol as a substitute for gasoline and so make her self-sufficient in this essential war material. Australia's protection of her steel industry is an example of a fortunate and wise policy. Some years ago her government imposed high duties on steel and built up a small steel industry that proved of great military value in World War II.

Diversification of industries has a value other than military, for a nation with many industries may be subject to less violent ups and downs of business than one whose economic activities are restricted to a few lines. This may be seen in the domestic economy of such a city as New

York, with her diversified industries, as contrasted with a specialized industrial center like Detroit or Pittsburgh. When the automobile industry is slack, Detroit is a sorry-looking city; and when the steel industry is in the doldrums, Pittsburgh has somewhat the appearance of a morgue. Our own South would probably be in a sounder economic condition if it had not devoted its energies so largely to the production of cotton. Chile used to be largely a single-industry country, concentrating on the mining of guano, and when the manufacture of synthetic nitrates was developed in other countries it left her in a serious financial condition. Similarly, Brazil's economic condition would doubtless be sounder if her economy were less concentrated on the production of coffee. However, it is possible that nothing constructive can be done about it, since tariffs designed to bring other industries to Chile and Brazil would only reduce the wealth and prosperity of the people.

Against the dangers of reliance on foreign supplies and markets must be balanced the cost of trying to maintain self-sufficiency, a cost which may be very great. It has been estimated that food tariffs in some European countries cost consumers about 20 per cent of their total income; and of course the French tariff on gasoline has been a heavy burden on motorists. For decades the German people have skimped on meats in order that their country might be less dependent on foreign supplies. If Denmark, with no important mineral resources for use in manufacturing, had nevertheless tried to maintain a self-sufficient economy, she would have been obliged to lower her standard of living greatly; similarly, Japan could scarcely have supported her dense population without developing manufacturing on a large scale and importing food and raw materials. As far as war needs for metals and other durable essentials are concerned, it would be much cheaper for most countries to buy and store a supply to last several years than to try to develop their own supply by means of heavy protection. Fortunately the United States is more nearly self-sufficient than any other country, with the possible exception of Russia, and the argument for diversification of industries has little pertinence here.

Tariffs and the concentration of wealth. For those with aristocratic views of human society, an appealing argument for protection might be that a tariff has the effect of increasing the concentration of wealth. Although tariffs tend to reduce the real wages of labor and to reduce the amount of goods available for consumers, they help build up great wealth for protected industrialists. The fortunes of Carnegie and the other steel masters and to a lesser extent those of the oil, lumber, sugar, copper, aluminum, chemical, and electrical magnates—indeed, many other great fortunes amassed since the Civil War—have in them an element of tariff alms. Whether these huge fortunes are larger in number and amount than they would have been without a protective tariff is debatable. As we have seen, such a tariff puts a burden on our more efficient export industries, as witness the automobile industry in recent years; but since it fosters the growth of monopolies it probably has increased the number of great fortunes. The possibility that this wealth might have been more productive in the hands of the masses of the people than in the savings of the rich need not be considered here. The point here is that a tariff probably increases the concentration of wealth and may therefore appeal to people with aristocratic sentiments. For some reason this argument has never been stressed in political campaigns.

Retaliation tariffs. Tariffs are sometimes urged as a proper means of retaliation for tariffs imposed by other countries. Adam Smith appraised this argument fairly: "There may be good policy in retaliations of this kind, when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer during a short time for some sorts of goods. . . . When there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people to do another injury ourselves, not only to those classes, but to almost all the other classes of them." A German tariff against American wheat does the American wheat farmer an injury just as truly as it imposes a hardship on German consumers; but it is unwise for the United States, in retaliation, to impose other tariffs, thus curtailing both imports and exports still more and imposing further hardship on both ourselves and the Germans. A man who has been kicked in the stomach does not find the best remedy for his pain in hitting himself in the nose. Furthermore, the United States has usually been in no position to use retaliatory tariffs with a straight face, because she has been the leader in trade restriction. Europe might well say, in the words of the sad old song, "You made me what I am today." A League of Nations survey in 1930 showed the United States up as having the highest level of tariffs of all the countries included, with the single exception of Spain.

All too generally, tariff arguments assume that only the home country works the racket, that foreign countries will generously suffer curtailment of their export markets without retaliation. Even if this were true, tariff protection would usually be injurious to the country invoking it; but with other countries engaging in the same unintelligent, selfish contest, trying to get rich by impoverishing each other, trying to pull themselves up by kicking the others down, the results are—well, just what we see about us today. Hitler and his gangsters were the logical product of the welter of poverty and hopelessness that resulted to some extent from the spread of tariff restrictions after the First World War. International tariff wars played no small part in bringing the world to the anarchic condition of 1939–1946.

The role that the United States has taken in this disastrous march to "autarchy" may be judged by the foreign reactions to the Smoot-Hawley tariff of 1930. In weighing these reactions we must consider the fact that foreign trade is far more important to other countries than to the United States, and that they are more seriously affected by the rising level of duties. It is necessary for many nations to import, and the means of purchasing must be provided by exports; and the United States, with her large population and high standard of living, is the most important market for many commodities. In 1930 we took two-thirds of the exports of Mexico, Cuba, Colombia, and certain Central American countries, and from one-quarter to one-half of the exports of Brazil, British Malaya, Japan, Canada, Chile, Peru, and Venezuela. Inevitably the revision of our tariff schedules was a matter of grave concern to these nations.[8]

Even while the Smoot-Hawley bill was under consideration in Congress, some thirty foreign governments protested against the proposed duties, newspapers in various countries of the world carried sharp criticisms of the American attack on world trade, and foreign commercial and agricultural associations threatened retaliatory tariffs and boycotts of American goods. The French government protested against the proposed advance in duties on lace, and 20,000 lace workers in Calais organized a protest parade and presented an appeal to the American ambassador. The French Minister of Commerce denounced the new American tariff bill as "a dangerous procedure," adding that "it is unfortunate that on this economic ground the warlike instincts of men are now let loose." The 400 to 500 per cent increase in the duties on watches resulted in a mass meeting of 15,000 clock and watch makers being called at Bern, Switzerland, at which a resolution of protest was adopted.

Foreign countries did not content themselves with mere protests. Within a few months after the passage of the Smoot-Hawley tariff, or the Hoover-Grundy tariff as it is sometimes called, Spain passed a new tariff law imposing practically prohibitive duties on automobiles, tires and tubes, and motion picture films. This new tariff reduced Spanish imports of American automobiles from 7415 in 1929 to 841 in 1931. Soon afterward, Italy raised duties on many American products, and Switzerland initiated a boycott of American products. France adopted a system of import quotas on American goods, prohibited all imports of American apples, pears, and grapefruit, and raised the duties on automobiles, trucks, and parts. Canada retaliated by erecting a "skyscraper" tariff against our most important exports. Austria adopted a complicated system of discrimination against American automobiles, films, and other products. Worst of all, in 1931 and 1932 Great Britain dropped her old free-trade policy and drew up a system of tariffs. Without much doubt this world-wide obstruction of international trade had something to do with the depressed economic situation in Germany, and so with the rise of Adolf Hitler. The United States, pious outfitter of peace ships, moving spirit in so many peace conferences, has thus been the leader in the tariff wars which, along with other things, were to make peace impossible.

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[8] Lawrence B. Mann, *Foreign Reactions to the American Tariff Act*, Foreign Policy Association, Information Service.

Tariffs and world peace

The problem of future tariffs and trade interference hangs like a cloud over all deliberations on international adjustments. The world faces problems so difficult as to seem almost impossible of solution, the tariff question looming large. As after the First World War, free trade is needed for the impoverished nations of Europe, but it is difficult to imagine those countries providing it. The national hatreds of centuries have been deepened by the brutality and sufferings of war; the destruction and dislocation incident to the war have made peaceful business seem less secure than ever before; and the chauvinistic militarism characteristic of wartime never dies out immediately. Furthermore, people in distress, ignorant of the cause of their distress, are likely to be motivated by a fatal and perverse logic to call for more of the very thing that is the cause of their distress—protection. This has been apparent in the United States to some extent since World War I. Altogether, there does not seem to be a very strong probability of establishing a new order of international amity, of restoring European and world trade, so that the densely populated nations may eat and the food-producing peoples exchange their surplus food for the manufactured goods that they need.[9]

Looking thus pessimistically at the problem of restoring international trade, some competent students, notably Charles A. Beard and J. M. Keynes, have argued that the United States may as well forget about foreign markets and establish her economy largely on a basis of self-sufficiency.[10] Beard does not start from the ordinary protectionist assumptions, he is not confused by any of the common protectionist arguments about "keeping the money at home," and he recognizes that self-sufficiency would mean a reduction in our standard of living. Yet he realizes the difficulty of maintaining foreign trade; he sees that much of our philosophy of foreign trade is concerned not with exporting goods in order to secure the foreign products that we need, but with finding foreign markets for the products that American monopolists could sell at home if they would reduce prices to a competitive level and if our purchasing power were so distributed that the masses of the people could buy the things that could be easily produced here. Beard is not a protectionist; but he is concerned less with efforts to revive foreign trade than with revising our economy so that our people can buy the goods that our own productive resources could provide, so that we need not see shirtless sharecroppers plowing under cotton, undernourished children and AAA restrictions on food production, unsalable surpluses, idle men, idle machines, and needy people. Beard believes that if we could get our economy to work efficiently, we could provide a fair living for our people without heavy reliance on foreign trade.

Keynes also turned to the idea of self-sufficiency some years ago, and follows somewhat the same line of reasoning: "The decadent international but individualistic capitalism in the hands of which we found ourselves after the War, is not a success. It is not intelligent, it is not beautiful, it is not just, is is not virtuous,—and it doesn't deliver the goods."[11] Keynes believes that much industrial production can be carried on in most countries with about equal efficiency, that we should no longer subject ourselves to world forces, that we must plan our own economies and that we can do this best in some degree of economic isolation. Like Beard, he sees that foreign trade is closely linked with imperialist expansion, and he believes that the cause of peace would be advanced by adopting a policy of "reasonable" isolation.

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[9] Adam Smith was likewise pessimistic about the possibility of restoring free trade in England: "To expect indeed, that the freedom of trade should ever be entirely restored in Great Britain is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it." Although his pessimism was justified for three-quarters of a century, England did finally adopt a policy of free trade. This was possible only because of the growth of powerful industrial enterprises which needed cheap food for their labor and foreign markets for their goods, and which realized that they needed these things and that free trade was the means of securing them. The old landed aristocrats, interested as they were in high prices for food and high rents, were the real protectionists, but their power was declining.

[10] Charles A. Beard, *The Open Door at Home.*

[11] *Yale Review*, Summer, 1933, p. 761.

There is some sense in all this, but not enough. International trade has failed to some extent to bring the benefits that are theoretically possible; yet there was an impressive rise in the standard of living in almost every country during the nineteenth century. International trade, as carried on by some of the great corporations, many of them monopolies, has sometimes been the cloak for imperialist expansion which brought international friction and war; but if there were free trade the world over, there would doubtless be less imperialist aggression than there is now. It is the imperialist interests that call for tariffs to insure them monopoly of coveted markets. As to war, economic isolation would certainly not reduce this danger but on the contrary would probably increase it; we have already seen how much international friction was generated by the Smoot-Hawley tariff. The United States, Russia, and the British Empire are large enough and their industries are sufficiently diversified to stand a regime of "reasonable" self-sufficiency without great hardship; but the loss would be considerable, and in a regime that even approached self-sufficiency the American economy would have to be changed so drastically that it is difficult to see how it could be democratically controlled. A considerable proportion of some of our important products is exported, as the accompanying table, for 1939, shows. To reduce production of these commodities to the level of our domestic needs would cause a severe economic wrench and could scarcely be done under a democratic regime. But that is not all. Many of our industries use materials that come from a considerable number of foreign countries. For example, the materials used in making automobiles come from eighteen different countries, those used in making furniture from twenty-five countries. Substitutes could be used for many purposes, but they would be expensive or inferior, or both.

PERCENTAGE OF TOTAL PRODUCTION OF VARIOUS COMMODITIES EXPORTED

Commodity	Percentage	Basis of Ratio
Copper	42.3	Quantity
Dried fruits	36.2	"
Tobacco leaf	34.4	"
Lubricating oil	33.6	"
Turpentine	33.2	"
Aircraft	33.0	Value
Sewing machines	31.6	"
Cotton	28.4	Quantity
Mining machinery	28.0	Value
Office appliances	22.2	"
Metal-working machinery	20.2	"
Tractors	19.4	"
Printing machinery	18.2	"
Agricultural machinery	14.5	"

Most countries would suffer even more from the strangling of foreign trade. If the United States and the British Empire were to adopt a generally prohibitive tariff policy, it would bring great hardship to many other nations by depriving them of markets and of sources of much-needed goods. This would hardly contribute to peace and international amity. Almost certainly it would drive some countries to warlike means of enlarging their domain in order to secure the markets and goods they need. The aggression of Italy, Germany, and Japan was to some extent an effort on their part to make themselves secure and self-sufficient in their trade relations. To some extent at least, their militarism was the answer to tariffs that threatened their markets and their sources of raw materials.[12]

Henry A. Wallace points up the conclusion to the self-sufficiency argument in statesmanlike terms:

> But the pain of a pinched-in national economy will, with our expansive capacities to produce, and our expansive desires to do so, prove so intense that we certainly ought not to abandon thought of a planned international drive for trade at this time [1934], when we have really given the question no

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[12] On national self-sufficiency, see Charles S. Tippetts, *Autarchy: National Self-Sufficiency*, Public Policy Pamphlet No. 5.

thought at all. Given a propelling common impulse to go the international way; given a steadfast national resolution to rebuild our agriculture and commerce on spacious rather than cramped, denying lines, America could exert a vast world influence toward larger, more rational and more decent trade designs.[18]

Reciprocal trade agreements

Some years ago the United States government, under the leadership of Secretary of State Hull, tried to secure some revision of tariff duties through the power granted the President to negotiate "reciprocal trade agreements," agreements to lower certain of our tariffs in return for similar concessions by foreign countries. Several of these agreements were negotiated by Secretary Hull, no doubt to the general benefit of the United States and the other countries involved. Although it is a statesmanlike policy, too much should not be expected of it. In the first place, like the tariff policy generally, it implies that it is fine and generous of us to buy from foreign countries, even when we can do so to our own advantage. It is a little like saying to these countries: "If you will stop kicking me in the stomach, I will stop hitting myself in the nose." The United States will gain by reducing tariffs, regardless of foreign reaction to such a step. In the second place, reciprocal trade agreements can avail little as long as the people are wedded to protection. When the agreement with Canada was published, there was a storm of protest from Wisconsin dairymen because duties were lowered on some Canadian dairy products. Any reduction in duties is certain to stir up protected interests, which are far more vocal than the consumer interests that gain from the reduction; and, judging by the present temper of the American people, any Administration that went very far with lowering our tariff through trade agreements would be repudiated at the next election.

Increasing government control of foreign trade

Foreign trade almost everywhere is coming more and more under government control, and there is a grave possibility that the end toward which we are drifting is absolute control, somewhat as it operated in the Fascist countries. The complete regimentation of Germany's domestic economy under the Nazis called for the equally complete control of foreign trade. One of the postwar problems facing the United States and the rest of the world is the choice between a liberalization of tariff restrictions, perhaps with some form of international cooperation under a new League of Nations, or the return to the old trade restrictions, economic distress, and international friction and ill will, and the clear possibility of another slide into the sort of international anarchy out of which Hitler arose, and out of which another Hitler might arise. As Wallace says, "America must choose," and the other nations of the world must choose. Looking at the present world with coolly appraising eyes, we can feel only moderate confidence that the choice will be a wise one.

Interstate tariffs

The Constitution of the United States wisely prohibits interstate tariffs, yet there has been in recent years an alarming growth of what amounts to such tariffs. They have been imposed by means of devious subterfuges which the Supreme Court has unfortunately approved. When a sales tax was imposed in the state of Washington and the merchants in cities near the state line lost business to outside merchants, the state levied a "use tax" on "foreign" products to compensate for the sales tax. This legislation has been copied by several other states. In some states, motor vehicle regulations and tax laws and the establishment of "ports of entry" have raised serious obstacles to interstate trucking; in some cases these restrictions are so onerous as to make interstate trucking almost impossible. Other states have passed laws requiring that finished products produced locally shall contain a certain percentage of local materials. Restrictions have also been imposed by means of state health, sanitary, and quarantine regulations. Thus milk and other dairy products have been shut out under the pretense of regulating the sanitary conditions in dairies; fruits and vegetables have been barred under quarantine regulations guarding against insect pests. Florida, for instance, still excludes California citrus fruit to prevent the introduction of brown rot, although California has long been free of this disease. Texas shuts out Florida citrus fruits from the northern part of the state during certain seasons to give her own growers a virtual monopoly of that market. A number of states have passed laws taxing liquor distilled outside the state. Among the much-debated measures are the excise taxes, ranging from five to fifteen cents a pound, that several states have imposed on margarine. A variation in state protection is seen in California's restrictions on the entrance of people into the state, which were fortunately declared unconstitutional by the Supreme Court.

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[18] Henry A. Wallace, *America Must Choose*, World Affairs Pamphlet No. 3. This is one of the ablest brief presentations of the tariff problem faced by the United States.

This "Balkanization" of the United States has gone so far as to offer a serious threat to our standard of living. Like national tariffs, these state tariffs are secured through the efforts and for the benefit of small business groups, which thus gain at the expense of the people as a whole. They are spreading with alarming rapidity, for every such measure invites retaliation by neighboring states. Like national tariffs, these state restrictions fit in with the general protectionist philosophy of the American people, and they are backed by powerful business interests, in some cases by businessmen generally. For these reasons there is little hope of eliminating them, unless the Supreme Court can be educated to see the economic consequences involved.

QUESTIONS

1. Explain why a country may import goods that it can produce more efficiently than the country from which it imports them.
2. "Exports tend to stimulate imports, and imports tend to stimulate exports." Do you agree?
3. Distinguish a protective tariff from a revenue tariff. How does a tariff protect? Whom does it protect, and from what?
4. "A favorable trade balance is an excellent sign of vigorous national life and of a sound economic structure. It means that the nation is taking in more than it is paying out." Comment on the logic of this.
5. "If we buy clothes from England, we get the clothes and England has the money. If we buy them from our own manufacturers, we have the clothes and the money too." What is the error in this reasoning?
6. "A tariff can do nothing that an earthquake could not do quite as well." Explain. Should protectionists favor earthquakes?
7. Would it be fair to require everyone who seeks tariff protection to take a pauper's oath? Is it fair to say that the tariff was the first form of poor relief?
8. A reduction of $60,000,000 in tariff duties, according to Senator Newlands, means a reduction of $600,000,000 in the burden the people must bear. Can this be possible? Explain.
9. Presidents Coolidge and Hoover believed that a tariff really increases imports by increasing the wealth of the people and thus increasing their ability to pay for imports. Could this be true?
10. If the Israelites had been protectionists, what would have been their policy with respect to the manna sent from Heaven? "Imports of goods from Europe in payment of war debts after the First World War would have been like manna from Heaven." Do you agree? Explain clearly.
11. "American wages will be slaughtered by Oriental competition unless protectionists in and out of Congress unite to put up the protection bars." Criticize.
12. Explain how the prosperity of our cotton and wheat producers depends on a reduction of tariffs.
13. "A tariff on imports of *goods* from Europe *reduces* real wages in the United States; a tariff on imports of *laborers* from Europe *raises* wages in the United States." Explain.
14. If a country maintains a favorable balance of trade, in both visible and invisible items, and invests the balance abroad, is its wealth not growing? Is it gaining more than it would if it

imported more? If it is to gain from this increase in wealth, what must its foreign trade policy finally be? In this situation, what was the British trade policy? What has been our own?

15. "Internal commerce does not increase the wealth of a nation, since it only transfers goods from one person to another." Criticize.
16. "Keep American money in America, Kansas money in Kansas, Douglas County money in Douglas County, Lawrence money in Lawrence." What would be the result of this?
17. In 1880, a famous Georgia orator described a funeral in his state as follows: "The grave was dug through solid marble, but the marble headstone came from Vermont. It was in a pine wilderness, but the pine coffin came from Cincinnati. An iron mountain overshadowed it, but the coffin nails and screws and shovels came from Pittsburgh. With hardwoods and metals abounding, the corpse was hauled on a wagon that came from South Bend, Indiana. A hickory grove grew near-by, but the pick and shovel handles came from New York. The cotton shirt on the dead man came from Cincinnati; the coat and breeches from Chicago; the shoes from Boston; the folded hands were encased in white gloves from New York, and round the poor neck, that had borne all its living days the bondage of lost opportunity, was twisted a cheap cravat from Philadelphia. All that the South contributed to the funeral of one of its sons was the corpse and the hole in the ground." If some of the things mentioned could have been produced cheaply in Georgia, why had no industries been established there? Does the situation suggest that interstate tariffs would increase the wealth of the various states? If by means of such tariffs Georgia could have built up industries and increased her population by 1,000,000, would her people have lived better? Do the people of Massachusetts live better than those of Idaho or Nevada?

Part V

THE DISTRIBUTION OF WEALTH

Chapter 26.

Wages

We have now completed our study of the problems of production and exchange, and must take up the problem of distribution—the distribution of the wealth and income of society.

Distribution of wealth defined

Distribution, in the study of economics, may refer to three different processes. First, as used in the study of marketing, it refers to the *physical distribution of commodities* among consumers. We are not concerned here with distribution in this sense. Second, it may refer to the *personal distribution* of wealth or income among the various individuals or classes in society, emphasizing the problem of economic inequality. Third, it may refer to the *functional distribution* of the income of society among the four factors of production—labor, capital, land, and the entrepreneur. This is the sense in which the word is generally used in economics, and the sense in which it will be used in this chapter.

Distribution a problem of growing importance

The problem of functional distribution is far more important than it once was. In George Washington's time, for instance, nearly nine-tenths of the people of the United States lived on farms, where the economic life was simple, where there was generally no labor problem, and no serious rent problem since most farmers owned their own farms, and where, although quite a few men were in debt and there was considerable complaint of high interest rates, there was far less indebtedness than there is today. Farmers generally owned their own land, furnished their own capital and labor, managed their farms, and received an income which combined rent, interest, wages, and profits in proportions that individual farmers were not much concerned about. In recent years, on the other hand, the situation of the farmers has become such as to make distribution a more important problem. With a steadily rising percentage of tenant farmers, the problem of rent is more serious; with heavier debts, the problem of interest has assumed greater importance; and in some parts of the country the development of corporation farming has created a rather serious labor problem. Even more important, a larger and larger proportion of our people live in cities, where the problems of wages, rent, interest, and profits are of greater significance than in farm communities. Here in the cities are great factories representing vast aggregations of capital, with armies of workers, few of whom have any property interest in the plants in which they work; here are business sites whose rents would be sufficient to pave them in gold; here is a complex and interdependent economy, with wealthy landowners, capitalists, and entrepreneurs, and with many laborers; and the proportion in which these classes share in the total income becomes a problem of very great importance.

Different approaches to the problem of distribution

The problem of functional distribution, like that of value or price, may be approached in different ways. In general, Marshall follows a *demand and supply* analysis, but more recently economists have turned more and more to the *marginal productivity* analysis. Although Marshall uses the latter to some extent, he stresses the broad forces of demand and supply as determining prices of goods and of labor, capital, and land—wages, interest, and rent. The reward of the entrepreneur is assumed to be governed by somewhat different principles. According to the marginal productivity theory, in a purely competitive economy wages, interest, and rent are best explained *in terms of* the marginal productivity of labor, capital, and land, if not actually *determined by* the marginal productivity of these factors. The two theories, correctly interpreted, are not contradictory but represent different approaches, with a different emphasis. We shall follow the demand and supply analysis as a rule, but at the same time try to show the significance of marginal productivity as a necessary part of a complete theory.

Wages defined

Labor may render a *service* directly, as in the case of servants, actors, entertainers, and musicians, or it may engage in the production of a *commodity* which consumers want. Wages may be *time wages*, paid by the day, week, or some longer period, or they may be *piece wages*, paid by the piece. The higher grades of labor are usually thought of as receiving *salaries* rather than *wages*, and their contracts of employment usually run for a longer term. Such princely academic potentates as football coaches are often hired for as long as five years. Finally, wages may be *money wages* or *real wages*, the former referring to the amount of money paid, and the latter referring to the amount of goods and services that the money wages will buy. It is real wages that are important and that will always be meant in this book, unless otherwise specifically stated.

Constancy or inconstancy of employment

In comparing the wages for different kinds of work, careful consideration must be given to the actual time during which the wages are received, that is, to the constancy or inconstancy of employment, and to the average length of the worker's productive life. Occupations differ greatly with respect to the steadiness of work, those in which there are many days of idleness paying a higher daily wage but not a higher annual income. One of the reasons why carpenters do not always receive as high an hourly wage as brick masons and plasterers is that carpenters usually have more work days in the year, partly because they can work indoors in the winter. To many people the wages paid plumbers seem unreasonably high, as indeed they often are; but a plumbing shop is expected to keep enough workers around for almost any emergency, and this may mean idle men part of the time. Coal miners receive a rather high daily wage, but because of the seasonal character of their work they are idle so much of the time that the yearly wage is not very high. Men and women who are paid salaries and thus have a steady income each year often do not realize how small are the total wages of many laborers who hire out, even at high wage rates, by the day, week, or month.

Length of the worker's productive life

The total amount of wages received for different kinds of work, and therefore the average wage figured for the lifetime of the worker, varies according to the average length of productive life in the various kinds of work. There are some jobs in the automobile factories, "young men's jobs," at which only a strong man can work more than ten or fifteen years because of the muscular strain involved. The life of painters is generally short, because of exposure to lead poisoning, particularly where spray painting is done. The accident and death rate in mining is high, and the average life is short. When the twelve-hour day prevailed in the steel industry, many workers were worn out at the age of fifty. The work of actors and actresses sometimes involves severe nervous and physical strain which shortens their average life; and in many cases their productive life lasts only a few years, because public tastes change so quickly, or technological changes may put them out of work. When the talkies displaced the silent pictures, for example, players with poor voices were no longer wanted. Many farmers, on the other hand, can continue to do some kinds of farm work, not the hardest tasks, until a fairly advanced age.

Professional men can seldom begin their life work until rather late, but their productive abilities may last well into old age. A lawyer usually does not have a large practice until he is at least thirty years of age, but his abilities and income may increase steadily until he is seventy or more.

History of wage theories

Modern wage theories begin with the physiocrats, a school of economic writers of about the middle of the eighteenth century. The physiocrats assumed generally that the growth of population kept wages at a subsistence level, although they admitted some exceptions to this. The assumption was valid in France at the time, for taxes were so high that the peasants and laboring classes lived only a little above the starvation level, and when harvests were short some of them actually starved to death. Like the physiocrats, Adam Smith assumed a subsistence theory of wages, but, on the basis of conditions in England at the time (1776), he conceded that labor often received considerably more than a bare subsistence. In some passages of his epoch-making *The Wealth of Nations,* he approached the demand and supply theory of wages, although he did not formulate it clearly. Thomas Malthus, who published his famous book on population in 1798, assumed generally that the tendency toward overpopulation would hold wages down to the subsistence level, although he realized that this thesis might be invalidated by postponement of marriage—"moral restraint," as he called it. David Ricardo (1817) is often thought of as the exponent of the "iron law" or subsistence theory of wages; but although at times he did assume that wages tended to be fixed at this level, he recognized that the subsistence level was not fixed by the physiological necessities of life but varied with the standard of living.

With the publication of Senior's *Outline of Political Economy* in 1836, the *wages-fund theory* was first formulated, to be elaborated by John Stuart Mill in 1848. According to this theory, wages depend on the number of laborers on the one hand, and on the size of the *wages-fund,* that is, the capital "expended in the direct purchase of labor," on the other. Regarding this theory, which really is one form of the demand and supply theory, several things may be noted. In the first place, stated simply, it is a truism, for of course the amount paid to labor, divided by the number of laborers, is the average wage. In the second place, it stresses the size of the population, the number of laborers, as an important element in wage determination Mill was greatly influenced by the Malthusian doctrine and believed that overpopulation was the main cause of low wages and that only through birth control could the condition of the working classes be improved.

Even before Mill popularized the famous wages-fund doctrine, there had been clear suggestions of a *productivity theory* of wages; and after his time a number of economists insisted that wages were determined by the productivity of labor rather than by the relation of the wages-fund to the number of laborers. The wages-fund doctrine seemed ill fitted to American conditions, where the high productivity and high wages naturally led several economists to a productivity theory, Francis A. Walker, Henry George, the great single-taxer, and Frank W. Taussig assuming leadership. Walker insisted that labor produces its own wages, and that therefore an increase in population might not reduce wages at all; that wages are ultimately paid out of the product of industry, and that the employer needs only to *advance* the wages until he can market the product, since he usually has to pay his laborers before he sells the product. J. B. Clark amended Walker's productivity theory to formulate a "final" (marginal) productivity theory, which has been widely accepted by economists ever since. According to Clark, if we add units of labor—1000 laborers constituted a "unit" in his analysis—maintaining the capital supply unchanged, whatever the last unit of labor adds to the product is the "final productivity" of labor and the regulator of wages. With competition among entrepreneurs, no entrepreneur can secure labor's services for less, and of course none can pay more. Taussig, following Walker, added a further refinement to this wage theory in his discounted marginal productivity theory, according to which the marginal productivity has to be *discounted* at the prevailing rate of interest for the period, perhaps from six months to a year, for which the entrepreneur must *advance* the wages before he can sell the product. That is, if the marginal laborer adds $3 to the daily output, if the wages are paid a year before the product is marketed, and if the rate of interest is 6 per cent, the wage will be $3 minus 18 cents, or $2.82. All the theories mentioned here assume pure competition among employers, for the significance of monopoly and monopolistic competition was not yet clearly appreciated.

Marshall's theory of wages

In the meantime, Alfred Marshall came forward with a wage theory which combined both the demand and supply and the marginal productivity theories, giving demand and supply the more significant place but including the marginal productivity analysis as an important element.[1] Marshall's theory, which is the one we shall discuss in this book, may be stated as follows: *Under competitive conditions, wages are determined by the general conditions of demand and supply, at a point equal to the marginal productivity of the particular grade of labor; and the shorter the time under consideration, the more attention must be given to conditions of demand, and the longer the time under consideration, the more attention must be given to conditions of supply, that is, to the birth rate, or standard of living.* This theory, it may be noted, is consistent with our general theory of price, which also followed Marshall's analysis.

Peculiarities of wages in price analysis

For the long run, the principle of demand and supply operates differently, in two respects, in the determination of commodity prices and in the determination of the *general level* of wages in any nation or geographic area. In the production of commodities, a higher price will bring forth a greater supply, at any rate in the long run, whereas a higher wage may in the long run result in a reduction rather than an increase in the supply of labor. A higher wage enables laborers to secure more comforts, a better education, and a taste for the refinements of life; and all this will lead to a reduction of the birth rate and in the long run to a reduced supply of labor, which in turn may cause a further increase in wages. A fall in wages, on the other hand, may in the long run bring labor to a condition of stolid hopelessness in which the birth rate, and finally the labor supply, may increase and perhaps cause a further reduction in wages. The effects of a rise or fall in wages may be cumulative in this way and also in another way. A higher wage not only may reduce the birth rate but will almost certainly result in increased efficiency, which will be a second factor favoring still higher wages; whereas a fall in wages is likely to reduce efficiency as well as raise the birth rate, and for both reasons it brings a further decline in wages, in some cases to a point little above the subsistence level.

This doubly cumulative operation of the law of demand and supply partly accounts for the vast differences in income in a capitalist society. In the United States prior to 1939, there were more than 2,000,000 "families and individuals" with incomes of less than $250 a year, and more than 5000 with incomes of over $100,000 a year. Not all these incomes can be classed strictly as wages, and the differences were not due entirely to the operation of competitive demand and supply, for some of the low incomes were the result of exploitation, and some of the high incomes represented largely unearned profits of monopoly or were otherwise unearned; but however classified and however gained, they represent differences which are in part the result of the cumulative interaction of wages, efficiency, the birth rate, and the standard of living. The higher incomes go generally to the classes that have had fairly high incomes and good educational advantages, perhaps for several generations, and who as a result have small families and are therefore able to maintain their high incomes, or even raise them. The low incomes usually go to the classes that have long had low incomes and little education, and who as a result have large families which tend to perpetuate their poverty, their lack of education, their inefficiency, and in turn their high birth rate.

High wages *for any particular kind of labor* will, however, cause an increase in the amount of it by attracting workmen from other kinds of labor, if there are no insuperable barriers to such a shift, barriers set by requirements as to ability or training or by union regulation. The high wages of automobile mechanics resulted in an increasing supply within a very few years; the high salaries that were paid to accountants two or three decades ago soon brought an army of well-trained men into the labor market. To some extent, however, such an increase in the supply of available labor is the result of young men entering the highly paid fields who have not previously been working.

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[1] Marshall is not at all clear as to his attitude toward the marginal productivity theory, but we cannot elaborate his inconsistencies.

A second difference between the operation of demand and supply in the determination of commodity prices and of wages lies in the fact that the prices of commodities are the amounts paid for the commodities, whereas wages are the prices paid not for the laborers but for their *services*. But the laborer is inseparable from his services and must deliver his labor in person, perhaps in unhealthful surroundings. As Marshall says: "It matters nothing to the seller of bricks whether they are to be used in building a palace or a sewer: but it matters a great deal to the seller of labour, who undertakes to perform a task of given difficulty, whether or not the place in which it is to be done is a wholesome and a pleasant one, and whether or not his associates will be such as he cares to have."[2]

Laborers who do disagreeable work are paid higher wages than those doing more agreeable work *that demands the same grade of ability;* but unfortunately most dirty, unhealthful, motonous, or disagreeable work does not require a very high grade of ability and therefore earns a low wage. In spite of the unpleasantness of the work of street sweepers, garbage collectors, and washwomen, the supply of labor fit only for such employment is always so great that the wages are low. Few social changes are more needed than a reduction in the supply of such labor and a rise in its wages. Many otherwise intelligent people insist that there should be a great many such people to do the dirty work for the more fortunate classes; but if these laborers were scarce and wages were high, machinery would soon be invented to take over much of the hardest and most disagreeable work.

Still another peculiarity of labor as a commodity is the fact that it is highly perishable, and what is not sold is entirely lost to its owner. If the laborer were able to store up his days of labor as wheat or shoes can be stored, and sell it whenever the market seemed favorable, he would be in a stronger position, although even under this condition he could not meet the employer on equal terms, for the laborer is usually poor, has no reserve funds, and, like the sharecropper with his cotton, must sell his labor at whatever wage he can get in order to earn a living from day to day or from week to week. As Adam Smith said: "In the long run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate." A few days of unemployment may give him a chance to rest and to store up his energy for later employment; but as a rule unemployment, particularly if it lasts long, is likely to reduce his strength, energy, and ambition, and to leave him less able to work than before. Unemployment is the poorest kind of leisure, very likely to be demoralizing. This difference between labor and other commodities is only relative, for some other commodities are also highly perishable: many vegetables and fruits, milk, clothing which is subject to rapid style changes, new novels which must catch the public eye quickly or pass into oblivion.

Only demand significant in the short run

To the extent that there is competition, wages, like all prices, are determined by the general conditions of demand and supply; and, as with all prices, the shorter the time under consideration the more attention must be given to conditions of demand, and the longer the time under consideration the more attention must be given to conditions of supply. In the short run, only the demand can change very much. A good illustration of a sudden change in demand is seen in our shift to a war economy in 1941 and 1942. Within a few months after the declaration of war, the demand for labor to produce certain war goods increased very greatly, and wages rose 100 per cent or more; while the demand for labor to produce certain proscribed goods like electric refrigerators and radios disappeared entirely. A less dramatic change, unrelated to government policies, was that which followed the onset of the depression in 1929; within a year or two the demand for workers in the steel mills had declined to a fraction of what it had been.

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[2] Alfred Marshall, *Principles of Economics*, p. 566.

The demand for labor: productivity

The demand for labor is usually a derived demand. Most labor is wanted for the sake of its product, and so productivity is a very important factor in wage determination. In a simple case the laborer's product may indeed *be* his wages. A farmer, for instance, may cultivate a garden to grow vegetables for his table. Subtracting a small amount for the rent of the land and the interest on the capital that he uses, we have a product which may be thought of as his real wages. Since the farmer uses his own product, he is not involved in any market transactions; he does not have to sell his vegetables and buy other things with the money he receives.

A somewhat more complicated situation is presented by the work of the old-time cobbler who went from house to house making shoes to order. Here there was no rent to subtract, and but little interest, for the cobbler used only a few simple tools. The product of his labor, however, represented not real wages, as in the case of the gardener, but productivity in *value,* because he had to convert the price he received for his product into the commodities which represented his real wages. In this case it is not incorrect to say that productivity —*value productivity*—determines wages. Included in this category are the people who render personal services as entertainers, doctors, dentists, lawyers, teachers, and servants.

Turning to a case that is somewhat more complex, we may consider a man who is self-employed, who under his own direction produces a commodity which he sells for the money with which to buy the goods he wants. About half of our farmers own their own farms, provide their own capital, and do all or most of their own work, thus combining the functions of entrepreneur, landowner, capitalist, and laborer. After subtracting rent and interest, such a farmer derives from the sale of his products a certain *labor income* which represents his money wages, including the wages of management. Here the productivity is expressed in terms of money whose purchasing power represents the farmer's real wages. In this case, if we ignore for the present the difficulty of finding a principle that governs the amount which must be subtracted for rent and interest, we may say that the farmer's productivity is the most important element in determining his wages, both as a laborer and as a manager. The amount he produces is not the only factor, for the price he receives for his product, and the prices of the commodities he buys with this money, also help to determine his real wages; and he may find that high physical productivity, if general in the farming business, brings low and not high wages. Many of the factors determining *value productivity* are beyond the individual farmer's control.

Marginal productivity

Coming now to the problem of wages in a broader labor market, of wages in industries employing many laborers of each grade and large aggregations of capital, we find it difficult to separate and identify the productivity of labor, for the output of such an industry is the product of many grades of labor and of capital, land, and the entrepreneur, all working together. Since the total output is the product of all the factors, none of which could produce anything without the others, it is impossible to single out any part of the output and say that it is the product of labor; but we can approach this through the concept of *marginal productivity.* If we hold the land, capital, and entrepreneurial factors unchanged and add a unit of a certain kind of labor, the increase in the product that results from the addition of that unit of labor represents the *marginal productivity* of that kind of labor. J. B. Clark used 1000 as his labor unit, but it would be quite as logical to use units of one or 100. To make this more concrete, let us assume that the manager of a cotton mill employing 1000 spinners keeps his land and capital unchanged, but adds one spinner, and as a result increases his output of cotton sheeting by 100 yards a day; then 100 yards of sheeting is the marginal productivity of cotton spinners in terms of goods. To put this in value terms, we have to figure its price—$10, let us say, at 10 cents a yard—and subtract the cost of the raw cotton, let us say $5. This gives us $5 as the marginal productivity of spinners in terms of money. This much of the total value productivity is *attributable to* the marginal laborer, since there has been no change in the amount of land, capital, management, or other kinds of labor.

This concept of marginal productivity may be applied to capital and land as well as to labor. In analyzing the forces that determine the interest rate we shall change the hypothesis and assume that the employer keeps his labor and land constant and adds a unit of capital. The addition to output will be the marginal productivity of capital. In the case of rent, we assume that labor and capital are fixed, and that a unit of land is added. The increase in product resulting from this addition is the marginal productivity of the land, and will approximate the rent. The concept of marginal productivity, in this simple form, is valid only under competitive conditions.

This is a rather fanciful picture of actual business operations, for an employer would seldom or never be in exactly the position we have presented. He would be as likely to add both labor and capital as to add either one separately, and it would usually be difficult for him to figure the marginal productivity of either labor or capital. Yet he *must* in some way, and as accurately as possible, decide how many laborers and how much capital he can employ profitably, and in doing so he must follow some such analysis as the above.

Marginal productivity, as thus defined, is an important factor in the determination of wages. The employer hires labor for the sake of its product, and in pure competition he must pay any given grade of labor the value of its marginal product. He cannot pay more than this, for he will lose by doing so; and in pure competition he will have to pay this much, because if he does not, some other employer will. Thus it is clear that under competitive conditions wages tend to *equal* marginal productivity; but it is not correct to say that wages are *determined by* marginal productivity. Wages are determined by the general conditions of demand and supply.

Why marginal productivity may be high or low

Marginal productivity may be high or low for two different reasons, one of which relates to the *quality* of the laborers, and the other to the *supply* of laborers. Labor which is lazy, slow, or unintelligent will have low general productivity, and therefore low marginal productivity, no matter what the supply of it may be. The labor in many tropical countries is of this type; and no matter how scarce it may be, its marginal productivity will be low, and therefore its wages will be low. The reverse of this is not necessarily true, however. Labor may be energetic and intelligent and yet not have very high marginal productivity if the supply of it is very great in relation to the supply of the other factors of production. Labor in such countries as China, Japan, Czechoslovakia, and Finland is energetic and intelligent, but since it is oversupplied in relation to land and capital, particularly land, its marginal productivity is not very high. This is of course because of the principle of diminishing productivity.

Elasticity of the demand for labor

The demand for labor which is employed in producing goods is a derived demand, derived from the demand for the product of the labor. It is difficult to generalize about the elasticity of the demand for labor, but Boulding offers three propositions as valid.[8] In the first place, "*the more elastic the demand for a product, the more elastic is likely to be the demand for the types of labor which go to make the product.*"

In the second place, "*the smaller the part played by a factor of production in the production of a commodity, the more inelastic is the demand for it likely to be.*" Let us assume that a tile setter sets the tile around the fireplace of a house in one day, and that his wages are raised from $12 to $24 a day. This 100 per cent increase in his wages will raise the price of a house only $12, and will have very little effect on the number of houses built, and therefore on the demand for tile setters. The demand for tile setters will be inelastic. If, on the other hand, the construction of a house calls for 200 days of work by carpenters at a cost of $1000, and carpenters' wages are raised 100 per cent, the cost of the house will be increased $1000, considerably fewer houses will be built, and considerably fewer carpenters will be demanded. The demand for carpenters will be more elastic.

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[8] For an able analysis of the demand for labor, see K. E. Boulding, *Economic Analysis*, pp. 220 ff.

In the third place, *"the better, and the cheaper, the substitutes for a factor of production, the more likely it is to have an elastic demand."* In some cases machines may be substituted for labor; and if wages rise considerably there may be some increase in the use of machinery, and the demand for labor will be elastic. In the mining of coal, for instance, mechanical loaders are used more in those districts of the West where wages are high than in other districts where they are low; moreover, the rise in wages which began in 1933 led to increased purchases of mechanical equipment in most districts. It is our generally high wages that have led to the lavish use of machinery in this country.

The supply of different types of labor in the short run

Conditions of supply in general cannot change quickly, yet the supply of *any particular type* of worker may change considerably in a fairly short time. The supply of common labor for a particular kind of work may be increased almost indefinitely in a short time, because it is not difficult to shift common, unskilled labor from one line of production to another. The supply of even such skilled workmen as carpenters is not absolutely fixed, even for the very short run. There are ordinarily some unemployed carpenters, perhaps fairly efficient, who will take jobs on a day's notice; and there are a number of what might be called "marginal" carpenters, men who are a little too young or too old or too inefficient to be regularly employed, but who will be put to work if the demand is strong. Outside these limits, the number of skilled carpenters can only be increased in a few years, the time required for apprenticeship. The supply of exceptional, highly trained professional workers —highly competent surgeons, for instance— can be increased very little in a short time, and only within certain limits even over a period of many years, because of the long training required and because there are few men with the natural qualifications required for such work.

The supply of labor in general in the short run

The supply of labor in general can be increased somewhat in a fairly short time, but a very considerable increase can come only in the long run, through immigration or from an excess of births over deaths. That there can be some increase in a rather short time is shown by the increase in our labor force after we entered the Second World War. Many unemployed men found jobs; old men, boys, and women who were idle or employed only part time took such jobs as they could do, partly lured by the high wages offered and partly moved by a patriotic desire to help win the war. A considerable number of women can be drawn into industrial work within a fairly short time. Thus the total supply of labor is to some extent elastic, even in the short run, although an increase in the number employed brings in labor that on the whole is less efficient.

The supply of different types of labor in the long run

The supply of labor seeking employment in a given line of work is determined (1) by the attractiveness of the work, and (2) by the qualifications demanded for it. The qualifications may in turn be either inherited or acquired.

The attractiveness of various kinds of work. Not all people find the same conditions attractive. Many love to farm, to work outdoors, to work under their own supervision, to take care of livestock or machinery, to dig in the ground. Abel started this business, and many people will never get away from it. Others love the crowds and hustle of the city, like "people better than hogs," or they may enjoy the physical comforts or the cultural advantages of the city. Some men enjoy mental work, others shirk it but do not mind hard physical work. Everywhere, however, people show an extraordinary adaptability to the conditions under which they work, and discount unattractive conditions much less than it might seem they should. It is hard for most people to understand how a man can endure the blood and filth in the shambles of a meat-packing plant, or the stench of a garbage truck, or the danger in a riveter's job forty stories above the street or in a miner's work a thousand feet below the surface of the ground, or the terrible heat of a stoker's job in the hold of a ship, or even the tedium of a bookkeeper's task of balancing figures. Yet people become so accustomed to such conditions that apparently they do not mind them very much, and their wages need not be much higher than those paid for pleasanter work.

To the extent that work is generally attractive, however, it will call out a large supply of labor and wages will be low, relative to the wages paid for less attractive work which calls for the same amount of training and the same grade of natural ability. Laundry workers usually receive higher wages than saleswomen in retail stores. Work which can be done in clean clothes and clean surroundings is likely to command low wages. For this reason, some of the so-called white-collar workers are paid less than skilled artisans. Women are particularly sensitive to dirty and unpleasant surroundings and will often accept very low wages if they can work in good clothes, with pleasant associates, and in attractive surroundings. The chance of meeting men who may turn out to be sweethearts and husbands is in some cases an extra attraction for women workers, tending to reduce wages. In the building crafts, plumbers and plasterers often earn higher wages than carpenters, partly because their work is not as pleasant as that of carpenters. Working with wood, like fishing, is so attractive that some men do it for diversion, but it is difficult to imagine anyone joining up iron pipes or spreading gritty plaster on walls for the fun of it.

Work which carries prestige is ordinarily sought eagerly and commands a relatively low wage. "Honour," as Adam Smith said, "makes a great part of the reward of all honourable professions." Teaching probably suffers in this respect. Musicians generally earn less than the natural talent and exacting and expensive training required would suggest as reasonable compensation, but there are "glory and honor" in musical performance. The law profession is somewhat overstocked with able men who have been attracted by the wide interest of the work, the dignity of throwing ponderous words at juries, and the chance of graduating to political office. Adam Smith observed, on the other hand, that what he called the "brutal and odious business" of butcher was more profitable than most common trades, and that "the most detestable of all employments, that of public executioner," was better paid than any common trade in proportion to the amount of work done, whereas fishermen earned very small incomes because so many men followed fishing as a pastime. The wages paid servant girls, including food and lodging, are generally higher than those paid salesgirls with similar character and training, because a position of social inferiority is distasteful to most people. There is some evidence that the junk business is more than ordinarily profitable today, partly because there is not much honor and glory in it, and partly because junk dealers have to work in rather dirty surroundings, but partly also because the business is fairly well monopolized.

Some kinds of government service carry honor and dignity, and sometimes power, and as a result are poorly rewarded in money. A judge's work is usually hard and exacting, yet lawyers are almost always glad to leave a remunerative practice for a relatively modest salary on the bench. Men in the diplomatic service often find their salaries too small to enable them to live in the style they must maintain, but few have been known to turn down ambassadorships for that reason. The salaries of Senators, Congressmen, Cabinet officers, governors, and other government officials with prestige and power are not high, yet such offices are sought by men who prefer them to business positions that pay much more. In some countries, many subordinate government employees are also paid relatively low salaries, for part of their compensation is honor and dignity, and in some cases the privilege of wearing decorative uniforms.

So important is the element of power and honor in some public work that the amount of the salary, provided it is high enough for a decent living, has little bearing on the level of ability of those willing to engage in it. An increase in the salaries of high government officials would be as likely to lower as to raise the average character of the men, because men who seek such positions for the sake of the salaries paid would often be unfitted for public office. It has sometimes proved wise to pay certain public officers no salary at all for work which does not take much time. If the work takes very much time, such a policy would close these positions to all who do not have independent means, and this might be an evil in a democracy, but it would tend to keep out men who lack the generous public spirit needed in some kinds of public work. In the professions, and to a lesser extent in common labor, any policy which lends honor and dignity to a task will lower the wages necessary to secure a given grade of ability and training. Some business concerns have found that they can get better men for janitors by putting them in uniforms and calling them porters.

Work which calls for long and expensive training, such as most of the professions, is likely to attract a small supply of labor and to be correspondingly well paid. Many young men cannot enter such lines because they cannot afford the expense of training, and some of those who can afford it are averse to the hard work required. On the other hand, the relatively short time and small expense involved in training for stenographic work make it possible for many girls to prepare for it, and keeps the wages low. The distinction between skilled and unskilled or common labor lies partly in the expense and time required for training. The expense of learning to be a carpenter or plumber is not very great, but an apprenticeship, in some cases lasting for several years, may be necessary. Common laborers, at the other extreme may learn all they need to know in a few days, and this type of labor is therefore always abundant and the wages are low.

Qualifications required for various kinds of work. Wages may be high for a given kind of work because of the scarcity of the natural talents it requires. The most obvious example is seen in the field of music—there was only one Caruso, there are only a few who have golden voices or other great musical talent. The income of musicians as a group is not high, but the few individuals who achieve great success earn princely incomes. Not many people can write successful stories or novels, although more may have the necessary natural abilities than we realize. The work of a great surgeon or lawyer requires natural abilities which are not very common; and even a good carpenter must have intelligence which many common laborers lack, intelligence which is probably in part inherited and in part the result of industry and application. Some unskilled laborers are unable to do any but the simplest tasks. The high wages which go to certain kinds of labor because of scarce natural talents may be thought of as quasi-rent—something *like* rent; but it will not be profitable to carry this analysis very far, because all wages above the lowest have in them an element of this quasi-rent.

The kind of work that calls for long and expensive training usually requires unusual natural abilities, and not all the income earned in such work should be regarded strictly as wages. As Adam Smith pointed out, some of it should be regarded as interest and amortization on the amount of the investment. Enough of the earnings should be set aside each year to return the principal of the investment during the period of productive work, with interest at the current rate. For instance, the National Bureau of Economic Research has estimated that the time and money cost of training for medicine is so much greater than that of training for dentistry that the incomes in medicine would have to be 17 per cent higher to equalize the labor incomes in the two professions. The Bureau estimated that as a matter of fact incomes in medicine are about 32 per cent higher, 17 per cent due to the time and expense of training, and the rest of the difference a payment for higher abilities or attributable to deliberate restrictions on entering the medical profession, restrictions similar in purpose to those imposed by labor unions.[4]

Wide ranges in incomes and average incomes. Just what is the effect on wages of a few high prizes in a given occupation is a question which cannot be answered with assurance. Marshall assumed that such an occupation would be attractive out of proportion to the aggregate value of the prizes, partly because young men of adventurous disposition are "more attracted by the prospects of a great success than they are deterred by the fear of failure," and partly because the social rank of an occupation "depends more on the highest dignity and the best position which can be attained through it than the average good fortune of those engaged in it."[5] But a recent study of the professions of accountancy, consulting engineering, dentistry, law, and medicine, made by the National Bureau of Economic Research, failed to yield much evidence to prove the truth of Marshall's assumption. The Bureau agreed that a wide range of possible income, with a chance for a very high income, was *probably* an attraction, which should mean that it would bring the average income down; but the statistical comparisons of these professions did not support this conclusion. In range of income, the professions ranked as follows: consulting engineering, law, medicine, accountancy, and dentistry; and in size of income they ranked the same, except that accountancy moved up from fourth to second place. Thus consulting engineering, the profession with the highest variation in range of income, also had the highest average income; and dentistry, with the lowest range, had the lowest average. The only conclusion to be drawn from this study, and from other evidence, is perhaps that wide variation in incomes has less to do with the attractiveness of a given occupation, and with the average income received, than various other conditions in that occupation.[6]

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[4] National Bureau of Economic Research, *Incomes from Independent Professional Practice,* Bulletin 72–73.

The supply of labor in general in the long run

For the long run, an increase in the supply of labor must come largely from an increase in the population; and the population, as we have seen, is determined by the birth rate, the death rate, and immigration and emigration. It is often said that the population, and to a large extent the labor supply, are determined by the standard of living, which we may define as the *standard of comforts and luxuries which men and women insist upon in preference to marriage or the rearing of children.* In order to maintain this standard of living, marriage may be avoided entirely or be deferred until later; after marriage, children may be avoided or be limited to one or two. Two children is standard equipment for upper middle-class American homes. Any nation or region in which men defer marriage, or at any rate defer the rearing of children until they are able to provide good home conditions and a good education for them, will have high labor productivity and high wages.

The standard of living as thus defined is analogous to the cost of production of goods. Ill-trained, poorly educated children can be reared in large numbers at low cost, like the gimcracks sold in the Woolworth stores; but the cost of rearing healthy, well-educated children is high, like the cost of producing quality goods of any sort. The man who insists upon rearing only such children must content himself with a modest number of them unless he has a fairly large income.

Cost of production and wages

We thus find that "cost of production"—the standard of living, the number of things preferred to marriage—is the significant factor in determining the general level of wages in the long run, the long run in this case referring to a period of at least a generation. The longer the time under consideration, the more attention we must give to this factor. If a nation or a region has a very high birth rate for a long time, it will almost surely have low wages, whatever the native quality of the labor; and for illustrations we need not go to India or China, for we can find them in certain parts of the United States. On the other hand, if the birth rate is persistently low or if emigration serves to keep the supply of labor down, wages may be high, even in rather barren and unproductive regions such as Wyoming, Nevada, and parts of California.

Relation of supply to marginal productivity

The entrepreneur, it will be remembered, wants labor for the sake of what it will produce, and so marginal productivity is the important factor behind the demand for labor; but marginal productivity must also be given some consideration in connection with supply. Accepting the demand and supply theory in general, we need the concept of marginal productivity to explain why, or under what conditions, an increase in the supply of labor may reduce wages. An increase in the labor supply does not necessarily or always reduce wages, as the history of the United States proves clearly enough; but if such an increase does reduce the marginal productivity it will reduce wages, because, under competitive conditions, labor gets its marginal product, or the value of that product, as a wage. If we were to adopt a marginal productivity theory of wages, we should have to explain marginal productivity by reference to the supply of labor, an increasing supply reducing the marginal productivity in a country subject to diminishing returns, and a declining supply raising it.

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[5] Alfred Marshall, *Principles of Economics*, pp. 554, 555.

[6] *Ibid.*

Why is the marginal (and average) productivity of labor low in China and high in the United States? Largely because of the great supply of labor in China and the small supply in the United States—in each case, supply in relation to the amount of natural resources and capital. Marginal productivity may be low for other reasons; but in comparing different countries we find generally a close inverse correlation between the supply of labor and marginal productivity. We might state the principle as follows: Supply is one of the most important factors affecting marginal productivity, and marginal productivity is the important factor behind demand.

Relation of marginal productivity to wages

Marginal productivity then tends to *equal* the wage paid, under competitive conditions. The productivity of the marginal laborer in one firm does not, of course, determine wages. The individual entrepreneur merely adjusts his labor supply to the wage determined in the whole broad field of demand for and supply of laborers. It is sometimes assumed, however, that if the concept of the labor margin is extended to include the marginal laborer in *all* firms, we may say, without falling into serious error, that marginal productivity determines the wage; but we should still have to explain the margin of employment in terms of the supply of labor, for marginal productivity is itself determined by various factors, one of which is the labor supply.

Marginal productivity may better be thought of as the average productivity of *all the laborers in a marginal plant,* for an increase in the population and the labor supply is more likely to result in the addition of more plants than in an increase in the size of existing plants. The optimum size of individual plants is governed largely by technological factors, and it is not certain that a change in the labor supply would affect it greatly; but an increase in the population and labor supply will call for more production, which, if we assume that existing plants are of optimum size, will have to come through the building of additional plants.

The productivity of the labor in such marginal plants would, however, no more *determine* the wage than would that of the marginal laborers in all the plants. Wages are determined by the broad conditions of demand and supply, and the employer in the marginal plant simply adjusts his operations to the wage which is thus determined.

Summary of the wage theory under competition

We are now in a position to summarize our theory of wages under competitive conditions. For both the short and the long run, wages are determined by the general conditions of demand and supply, with marginal productivity the important factor behind demand, and supply an important factor behind marginal productivity. For the short run, the labor supply in a given kind of work refers to the number of workers who are already engaged in that type of work or can shift into it quickly, whereas the supply of labor in general refers to the number of workers already employed or quickly available for employment at various wage rates. For the long run, the supply of labor in a particular line of work is determined by the attractiveness of the work and the qualities needed for it, whereas the supply of labor in general is determined by the birth rate, death rate, standard of living, and by immigration or emigration. As in the case of general price analysis, the demand is much the same in the short and the long run, but the supply differs for the two periods.

To the extent that the economy and the labor market are competitive, labor of a given grade has the same marginal productivity in all firms and in all industries, and earns the same wage. In a purely competitive situation, labor would be so distributed among firms and industries that no laborer could be shifted without reducing his productivity and therefore reducing that of the economy. Pure competition thus represents the situation in which labor produces the maximum possible total output and earns the maximum possible wage. To the extent that there is deviation from pure competition, output and wages are reduced below this theoretical maximum.

The student should again be warned that our analysis of wage determination assumes more exactness and precision in the adjustment of economic factors than are found in actual life. Wages, in pure competition, *tend* to equal marginal productivity; but we have seen that there is no purely competitive industry. Even more definitely, there is no purely competitive labor market, for in such a market there would have to be a large number of buyers and sellers of a standardized quality of labor, so that no buyer or seller could affect the wage in any way; and there is of course no such labor market. In most labor markets there are only a few employers bidding for labor, and in many small towns and farming regions there are only a few laborers offering their services; furthermore, labor, even in a given kind of work, is more or less heterogeneous, differing in health, strength, skill, reliability, and general sagacity. The requirements of a purely competitive market are lacking here. Labor is, moreover, a rather immobile commodity; and because of sentimental reasons or family ties or ignorance of comparative opportunities in different localities or industries, it may work in a given place for less than the wage set by demand and supply. This is true of many farmers. Nor are employers all alike—perfectly informed, perfectly selfish, perfectly heartless in their bargaining with labor—as they would have to be to fit the conditions of a purely competitive market. No doubt a few employers pay labor more than the demand and supply wage, perhaps even sharing with them a little of the profits; but other employers beat their labor down below the wage level representing marginal productivity. The economic mill, like the mills of the gods, grinds rather coarse; but it does grind. Wages *tend* to equal marginal productivity in a competitive market.

Monopoly, monopolistic competition, and wages

There is more or less monopoly in all urban industries, monopoly in the goods markets, and in the market for labor. Since it is in the urban industries that almost all labor is employed, it is necessary that we consider the problem of wage determination as affected by monopoly and by monopolistic competition.

In industry. Because of the monopoly in the urban industries and in the markets for goods, employers in these industries do not produce as much goods, and therefore do not hire as many laborers, as they would if they were operating in a purely competitive situation. Thus the effect of monopoly is to reduce the demand for labor because it reduces the output of goods. The monopolist or the monopolistically competitive producer faces a demand curve which slopes downward to the right, and therefore he has an incentive for restricting output. He does not gain the amount represented by the value of the product added by the marginal laborer, the marginal product, as a competitive producer would, for he must subtract from it the amount he loses by lowering the price of *all other* units of his product. In other words, the amount added to his total revenues by adding the last or marginal laborer is the marginal productivity minus the loss from price reduction; Chamberlin calls this the "marginal revenue productivity." It is of course less than marginal productivity; and since the monopolist gains less by adding laborers, he will hire fewer of them. Chamberlin concludes that "even a slight element of monopoly necessarily reduces the remuneration of all factors employed in a given firm below the value of their marginal products."[7]

Monopoly may depress wages not only directly, by reducing the demand for labor in monopolized industries, but indirectly, by forcing labor into competitive industries and reducing the marginal productivity and wages there. The monopolist does not have to pay more than competitive employers pay; and if the reduction in his demand for labor forces wages down in the competitive industries, he may in turn be able to reduce his own wages to that depressed level.

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[7] Edward Chamberlin, *The Theory of Monopolistic Competition*, 3rd ed., p. 181.

Monopoly reduces wages in another way. Since it restricts production, it reduces the supply of goods and so reduces the *real* wages of all labor, in competitive as well as monopolized industries. Indeed, since the real income of all the people *is* the total output of goods of all the people, this restriction of output reduces the real income of all the people, except the monopolists.

The monopolistic competitor, like the monopolist, has a sloping demand curve, and therefore he also has an incentive for reducing production and for hiring fewer laborers than would a purely competitive producer. Like the monopolist, he must lower his price as he adds units of output, and he can therefore pay labor only the marginal revenue productivity. There is this difference, however: since the monopolistic competitor faces competition and has to fight for customers, he must hire salesmen and advertisers; and it is possible that he may hire as many laborers as a competitive producer, but the energies of his salesmen and advertising staff will be to some extent wasted.

It must not be assumed from the foregoing that wages in monopolistic and monopolistically competitive businesses are *determined* by marginal revenue productivity. The monopolists and monopolistic competitors must adjust their production to the wage levels determined by the general conditions of demand and supply. They have no control over the total supply of labor, and each of them represents only a very small part of the demand.

In the labor market. If there were in the labor market, as in any purely competitive market, a large number of competing buyers and sellers, wages would be determined in approximately the manner described early in this chapter, and the problem of wages would not need to concern us to any extent. Nor could there be a serious deviation from competitive conditions if there were but few buyers of labor and few laborers. This situation is often found in the market for farm labor. Most farmers hire only one laborer, if any. The employer and the laborer meet on substantially equal terms, because the farmer needs the laborer about as much as the laborer needs the job, and each has some alternative in making the wage agreement. Here the wage represents roughly the marginal productivity of labor; in fact, studies of farm wages indicate that the average wage of farm laborers is about the same as the "labor income" of the farmer employer. Somewhat like this is the situation in the hiring of maids, if we may judge by the ladies' complaints of the truculence of their maids.

This simple picture does not fit the modern industrial economy, nor does the picture of a purely competitive labor market, with an army of employers bidding for labor and an army of workers bidding for jobs. In many industrial communities the labor market represents monopsony or oligopsony rather than pure competition. Monopsony is rare, but something approximating it is found in communities where there is only one industrial plant employing a large number of laborers, as in the copper smelter at Anaconda, Montana; the mines of Butte, Montana, and Bingham Canyon, Utah—indeed, many mines in various parts of the country—and some of the cotton textile mills in New England and the South. The employer does not control the wage rate completely in such communities, for no community is entirely isolated from the rest of the industrial area, and laborers can move to other places, or shift to other kinds of work, if wages are thought to be higher elsewhere. This means merely that the single industrial plant is not an absolute monopsonist in the labor market, but it may pay wages which are definitely below a competitive level, particularly if the laborers are unorganized.

If the labor employed by a labor monopsonist is strongly organized, it may induce the employer to produce more and to hire more labor, than if it is unorganized. In the latter case, the monopsonist employer may be able to hire labor more cheaply if he hires less; but if the labor is strongly organized it may set standard wage rates which the employer must pay no matter how many workers he hires, and so eliminate the incentive for restricting output and reducing his labor force.[8]

Oligopsony in the labor market is much more common than monopsony. In many industrial cities there are only a few employers of certain kinds of specialized labor, and they may pay somewhat less than a purely competitive wage. In some cases they are organized in employers' associations which offer a united front in dealing with labor, in this way shifting from oligopsony to monopsony, with a resulting increase in their bargaining power.

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[8] Mary J. Bowman and George L. Bach, *Economic Analysis and Public Policy*, pp. 474, 475.

In some labor markets there are too many employers to constitute either monopsony or oligopsony, yet they are too few and too strong to suggest anything approximating pure competition. In the market for retail sales labor in a city, for instance, there are many employers seeking labor; yet the owner of a big store who employs several hundred men and women is by no means in a purely competitive position, and he may keep wages below a competitive level. Such a concern as Montgomery, Ward & Company, notorious for its bad treatment of labor, is able to obtain the labor force it wants. But even in such a labor market, a ground swell of competitive forces is at work. Supply and demand operate, haltingly and fumblingly, to set a general level of wages which the employer must pay if he is to keep a full force of workmen. Laborers have some choice among employers, particularly in times of prosperity and brisk demand for labor. If an employer pays lower wages than those prevailing generally or if he provides poorer working conditions, he is likely to have to use less efficient laborers, those who cannot find work elsewhere, and he may also have a greater labor turnover because his workmen will be trying to find jobs elsewhere, and some of them will succeed. A high labor turnover, with the recurring necessity of training new men for jobs, may involve considerable expense; and for this reason, if for no other, employers are likely to want to keep their working force contented. Unusually efficient workmen obviously are always in a stronger bargaining position than the ordinary run of labor, and may be able to bargain a little with their employers.

Labor unions and wages

Opposed to employers' associations are powerful labor organizations, or unions, some of them definitely labor monopolies. Some of the unions are *closed;* that is, they try to keep down the number of members by long apprenticeship requirements, high initiation fees, and in other ways. Other unions are *open;* that is, they do not try to limit membership substantially. Both types try to maintain the *closed shop*—that is, keep non-union workers out— but their strategy in regard to wages is somewhat different.

A closed union often tries to maintain monopoly wages by restricting the supply of labor in its particular line of employment, in this respect operating in the same way as the aluminum, sulphur, or glass container monopoly does in selling its products. If such a union can keep its membership down, and can compel the employer to maintain a closed shop, it can keep wages above a competitive level without any wage negotiations or strikes, just as some of the lumbermen's associations, by reducing the output of lumber, were able to raise the price of lumber without insisting on the maintenance of price lists. A reduction in the supply of plumbers always raises wages, because the demand curve for plumbers' services, like practically all demand curves, slopes downward to the right, and a smaller supply can find employment at higher wages. Most closed unions have gone further than this, however, have demanded high wages, in some cases so high that some of their own members have been unable to find employment, somewhat as if the sulphur monopoly had restricted production and at the same time set prices so high that not all, even of the reduced supply, could be sold. Closed unions are labor monopolies, and they are often able to raise wages definitely above a competitive level but not above the level of marginal revenue productivity, because the employer would reduce profits if he hired labor at wages above this level. If such unions were strong enough to force employers to pay wages above this level, an employer would find it expedient to hire fewer workers, thus raising the marginal revenue productivity to the level of the wages demanded.

Open unions, on the other hand, do not try to limit the supply of labor. In this respect they differ from closed unions and from most monopolies, for the most important element in monopoly is control over supply, and most monopolies raise prices by restricting supply. An open union may be strong enough to force wages above a competitive level, but if it does, it will presumably throw some of its members out of work. Such a union could probably not raise wages as high as a closed union, but any given increase will create more unemployment.

Labor unions do not necessarily force wages above a competitive level. If modest in their demands, they may merely bring wages up to a genuinely competitive level. Where labor is unorganized, particularly if employers are strongly organized, there is a strong possibility that labor may receive less than this wage, for bargaining between the employer of 50,000 laborers and any one of the workmen does not represent a truly competitive process. Organization may merely give the laborers bargaining power equal to that of the employer.

Theoretically, a labor union in a single plant in a competitive industry can raise wages very little in the long run, unless the plant is earning exceptional profits. If it is an average or a marginal plant, it will produce at cost; and if the union forces wages above the level paid in other plants, the employer's profits will be reduced while competing plants will be in a position to expand. The long-run result will be that the unionized plant will have to close down, or at any rate will lag more and more behind nonunion plants. Slichter gives several illustrations of this.[9]

In some cases, labor unions do force wages above a competitive level, to the detriment of non-unionized labor—which includes about 75 per cent all labor—and of the public generally. The extent to which the monopoly wages of some unions reduce the real wages of unorganized labor depends on the character of the unionized firm. If it is a tight monopoly, outside laborers and the general public may suffer less than if it is almost perfectly competitive. A strong union in a tightly monopolized concern like the Aluminum Company of America might force wages up considerably; yet the company, enjoying a high inflow of monopoly profits, might absorb at least part of the wage increase. To a lesser extent, this may be true of a monopolistically competitive firm. A severely competitive industry, on the other hand, such as the cotton goods industry, would have to throw most of the wage increase onto the public in the form of higher prices. Such an industry would show no considerable pure profits and producers would sell at cost of production prices, or perhaps a little above, and hence would be unable to absorb much of the wage increase. Since the demand curve for cotton goods is fairly elastic, the industry would be obliged to reduce production and employment, thus throwing more labor into outside unorganized fields. Probably the total wages paid within the industry and in outside industries would be reduced.

A monopoly union, by forcing wages above a competitive level, reduces the sum total of consumer utilities, decreases employment in the industry, and forces labor into other kinds of employment, thus reducing marginal productivity and wages in these other lines of work. Consumers suffer as well as this displaced labor, for they are obliged to use the products of non-unionized labor when they prefer products made by union labor—at least this preference can be assumed because they will pay more for such products.

We have assumed here that the laborers crowded out of the industry find employment in other kinds of work. Theoretically they should do so in the long run; actually, however, they may find jobs only after a considerable time, and in this case the union would create unemployment. Such conditions would result in higher wages for union members, fewer of the monopoly-produced goods, and little or no increase in the production of other goods; while the unemployed might have to be supported by relief payments which would bring increased taxation, higher costs, and still further reduced production throughout industry. If union wages were very high, some of the members might be unemployed; in fact, so many might be unemployed that total wage payments, even to union members, would be no more, or conceivably even less, than they would have been at a lower wage rate. Such conditions as these have actually prevailed in some tightly organized industries.

If all laborers were organized, could they force the wages of all groups up? A generation or two ago, most economists would have said no, and even today many would say that they could not raise wages very much. Strict logic leads to the conclusion, as Gagliardo suggests, that the power of labor unions to raise wages is inversely related to the proportion of laborers organized, that the unions gain largely at the expense of the unorganized classes, and that if there were no unorganized classes to exploit in this way, the unions could gain little for their members. This general conclusion is subject to two qualifications, however. In the first place, fully organized labor might be able to divert something from profits, particularly from monopoly profits, force better management on employer. and in one way or another induce greater efficiency and lower costs. In the second place, even if all of what we call the laboring class were organized, there might be other unorganized classes—farmers, retailers, service employees of various kinds, teachers, and professional workers—which the organized laborers could exploit. If all these were organized too, if unionization covered *all* classes, the most powerful labor unions, those in the strongest strategic position, like the railway workers, would still be able to exploit the weaker groups to some extent.

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[9] See Sumner H. Slichter, *Union Policies and Industrial Management*, chap.

Laborers and employers both monopolized

In much of our discussion of trade unions, we have ignored the fact that employers are more or less monopolized. We shall now bring our analysis closer to reality by considering the situation that develops when a monopoly labor union deals with an employer who is a monopolist not in the labor market but in the market for goods. In this case *both* parties to the wage negotiations tend to force a reduction in output and an increase in price. The monopolist always has an incentive to reduce output, and the pressure of a tight labor monopoly gives him an additional incentive, by raising his marginal and average total costs. The situation may be graphed as in Fig. 38.

The curves in this graph should be familiar to the student, except curve *M′C′*, which represents the increase in marginal cost due to the monopoly wages exacted by the union. If the producer had been in a competitive business he would have produced *Oc* units at the price *Od*, because *m* is the point of lowest average total unit costs. If there had been no labor union, *Ob* units would have been produced, because the marginal cost curve crosses the marginal revenue curve at *p*, above *b*. But with monopoly wages, the marginal cost curve is raised to *M′C′*; hence the output is *Oa* because the new marginal cost curve cuts the marginal revenue curve at *n*. Thus the employer's monopoly position reduces output from *c* to *b*, the labor union monopoly reduces it further from *b* to *a*, and the price rises from the competitive level at *d* to *g* and then to *h*.

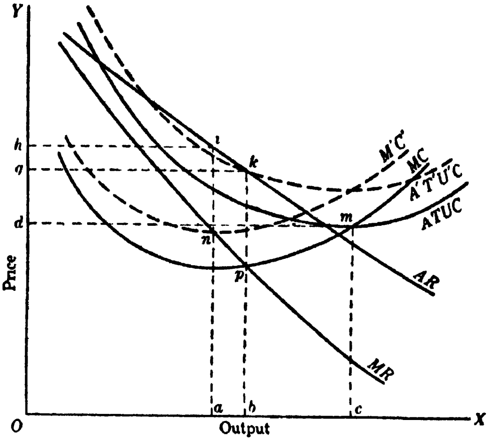

FIG. 38. Output and Price with Both Labor and Employer Monopolies.

But suppose that the monopoly labor union is dealing with an employer who is a monopolist not in the goods market but in the labor market, let us say a powerful monopsonistic employers' association. We have seen that here a labor union, by compelling the employer to pay the same wage no matter how many laborers he hires, removes one incentive for him to reduce output and curtail his labor force, and so may actually increase output and employment. But the employer who is competitive in the goods market must sell his output for the price set by demand and supply, over which he has no control; and if the union demands too high wages and he is covering only costs of production, he may find himself unable to cover costs and be obliged to leave the field. In this case there will be a reduction in output, higher prices of goods, and reduced employment of labor.

Such a situation as this is unusual, for nearly all employers who have monopsonistic power in the labor market also have some monopoly control in the goods market, some control over their prices. In this case, the employer monopoly and the labor monopoly will both tend to reduce output and employment and raise the prices of goods.

What has been said here must be construed not as an argument against labor organization in general, but merely as an analysis of some of the possible evil results. Marshall's conclusion, that labor as a whole suffers from the monopoly wages paid to strongly organized labor, that "it is the many who have been pushed down, and the few who have been pushed up," is apparently valid.

In the long run, however, an important effect of labor organization, if the unions are open, may be to bring into the unions a particularly high grade of men. The high wages paid organized plumbers, carpenters, brick masons, and plasterers frequently induce the most skillful workmen to join the unions; and building *may* be no higher with this skilled union labor than with the less able unorganized labor. In such a case, the efforts of the union to raise wages are evidently futile, for wages are no higher than they would have been without labor organization. It is of course possible, however, that high monopoly wages may attract a higher grade of workmen than is needed for the particular kind of work, and thus waste human talent.

This principle is important in relation to many types of public employment, in which no labor organizations are involved. It is difficult for a public agency to underpay or overpay its employees in the long run, for in the long run the grade of labor hired will tend to be adjusted to the wages paid. A state department or a high school or college that pays low salaries will tend in the long run to get about as much real ability as it pays for. There are many exceptions to this—many able men serving for small salaries and many amiable nonentities drawing handsome pay checks—but there is a rough validity in the rule.

Government wage fixing

One of the New Deal labor laws, the Fair Labor Standards Act, provides for the establishment of minimum wages in certain industries. What are likely to be the results of an effort to fix wages above the equilibrium level? According to strict theory, it should throw some workers out of employment. If conditions of demand and supply fix the wages of girls working in department stores at 30 cents an hour, it may be assumed that 30 cents measures roughly the marginal revenue productivity of this type of labor, and that a government-determined wage of 40 cents will deprive of jobs those who are not worth 40 cents. As in the market for goods, a price fixed above the equilibrium price tends to reduce the amount sold. But it is not absolutely certain that a minimum wage, if not too high, will cause much unemployment. Employers might find that they could offset much of the increased cost by increasing their own efficiency, by cutting other costs here and there, or some might even be content with slightly lower profits. They would probably be able to hire a better class of workers, and costs might not rise very much.

Wage differentials

To the extent that there is competition, the wages of any given kind of labor should and indeed do tend toward equality; yet they differ considerably on the basis of such factors as type of industry, size of community, size of establishment, and extent of labor unionization, among others. Wages are generally lower in the South; lower in northern than in southern New England; lower in southern Pennsylvania, Maryland, and Delaware than in New York, New Jersey, and northern Pennsylvania; lower in Kansas, Nebraska, and the Dakotas than in the states farther north and east—Ohio. Michigan, Indiana, Illinois, Wisconsin, and Minnesota. The most conspicuous wage differential is between the North and the South, wages in certain industries running from 10 to 20 cents higher in the North than in the South, and even more in some cases. In the fertilizer industry, wages are about twice as high in the North as in the "deep South"—South Carolina, Georgia, Florida, Alabama, Mississippi, Arkansas, and Louisiana. The factors behind this difference are difficult to appraise, but Perlman emphasizes "the fact that the South has been comparatively undeveloped industrially, and there is a larger supply of labor available there, with comparatively little training. The low money income which agriculture in that area can offer to many of these employees, and the consequent abundance of labor means that many southern plants have been able to get a labor force with much lower wages than typical northern plants." Other factors, probably less important, are the lack of widespread labor unionization, and a somewhat lower cost of living due to the warmer climate, cheaper housing, and lower expenses for fuel.[10]

The wages paid in different industries show great variations. Average hourly wages in 1937 ranged from 97 cents in the petroleum refining industry to 25 cents in the manufacture of cottonseed oil, cake, and meal. There are various reasons for these differences. Most of the low-wage industries, as for instance the cottonseed oil, cake, and meal, and the cotton goods and fertilizer industries, are in the South, where average wages are low, to some extent because of the employment of Negroes; many of these industries employ women, whose wages are usually lower than those paid men; and many of them employ a large proportion of unskilled labor. Since 1937 such wages have risen considerably, but wage differences persist.

Average wages tend to vary directly with the size of the community in which the industry operates. In the meat-packing industry in 1937, average wages in communities of from 25,000 to 50,000 population were 61.8 cents per hour, whereas in metropolitan areas of 1,000,000 and over they were 69.9 cents. The reasons for this differential appear to be the lower cost of living in small communities, the fact that labor is less generally organized there, and probably also the fact that the larger plants are more often located in the large cities. Usually, although not always, wages are higher in larger plants, because the better organization of such plants gives labor a higher productivity.

How can high-wage plants in the larger cities compete with small-town plants which pay lower wages? If the wage differences represent only higher labor productivity in the larger urban plants, these plants can of course compete on even terms; but to the extent that the wages are due to a higher cost of living or to more general unionization, it appears that employers there are at a competitive disadvantage and that they could produce more cheaply if they moved out of the large cities. As a matter of fact, this is exactly what some of them are doing. In many industries there is a tendency for plants to move to smaller communities; but lower wages are not the only reason for this shift, for taxes are usually lower too.

In many but not all industries, wages vary with the size of the company. In the manufacture of electrical goods, the average hourly wage for the "Big Three" in 1937 was 82 cents; for the intermediate-sized companies, 67 cents; and for the small concerns, 59 cents. In the meat-packing industry, the averages were 70 cents for the "Big Four," 64 cents for the intermediate-sized concerns, and 56 cents for the small packers. Since the large companies are not losing ground to the small ones, the high wages they pay apparently do not mean higher costs but are compensated by high productivity. Laborers work harder for large companies than for small ones, and their working equipment is usually superior. In some industries, however, there is no appreciable difference in the wages paid by large and by small companies.

Unionized labor generally receives higher wages than non-union labor. In the manufacture of wooden household furniture, the difference averaged 13.1 cents; in northern meat-packing plants, 6.1 cents; in the shoe industry, 7.6 cents per hour; and in the building trades it is sometimes considerably greater.

Importance of wage rates

Wages present the most important problem in distribution, for they represent the payment received by the people for their labor, which is the only productive resource that most of them have. We need not be greatly concerned if rents are low, for rents are not earned by productive labor, and they usually constitute an income in addition to the wages that the landowner earns, or can earn if he works. If interest rates are low, it means merely that there is an abundance of capital, generally a fortunate circumstance. Money lenders may suffer a reduction in income, but they are usually people of some means, and they can work and earn wages if their interest receipts fall too low. Profits are normally earned by men of the upper classes who do not suffer serious hardship if the rate drops. But considerably more than half our people work for wages and receive practically their only income as wages. If wages are low it means that most people must live poorly, and this is a far-reaching and serious evil.

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[10] Temporary National Economic Committee, Monograph No. 14. This monograph, written by Perlman, is an excellent analysis of wage differentials.

Public attitude toward wage rates

So obvious is this that one might think that everyone would want wages to be high; indeed most people, even in the employing classes, doubtless believe that they would be glad to see wages high and workers living well. But in reality, most of the upper classes do not want wages, except their own, to be high. As John Stuart Mill has said: "One may be permitted to doubt whether, except among the poor themselves (for whose prejudices on this subject there is no difficulty in accounting) there has ever yet been, in any class of society, a sincere and earnest desire that wages should be high. There has been plenty of desire to keep down the poor-rate; but that done, people have been very willing that the working classes should be ill off. Nearly all who are not laborers themselves, are employers of labour, and are not sorry to get the commodity cheap."

A little economic analysis will prove that there is logic in this, that only if many workers earn low wages can the upper classes make their high incomes cover the requirements of luxurious living. The rich and well-to-do can afford maids because the wages of maids are low; they can afford practically all the meats, fruits, and vegetables they want because the men who produce these commodities work for little and sell at low prices; they can wear fine clothes and furnish their houses with fine rugs, curtains, and furniture because the cost of these things needs to cover only modest wages for the workers who produce them; they can dine at luxurious restaurants and hotels because the employees work for very modest wages. In short, they can buy all these goods and services at low or reasonable prices because many workers, whose wages are the most important element in costs, are not paid much.

Now suppose that labor for some reason becomes so scarce that all workers must be paid a really high wage—say $40 a week, or $2000 a year—and see what changes this will make in the standard of living of a man receiving $6000 a year. A maid at $40 a week will take one-third of his salary, so he will probably have to do without a maid; a laundrywoman at more than $6 a day he may afford, but this will take nearly $300 a year and he will squirm when he pays it; the turkeys that he formerly bought for festive occasions at 40 cents a pound will now cost about $1.00 a pound, to provide the farmers' $2000 a year, and our gentleman may be inclined to shift to hamburger steak occasionally; if the workers who make his wife's dresses and his own clothes are to receive $40 a week, his clothing bill must go up about 100 per cent, which means that both he and his wife will have to cut down their clothing expenditures to a modest figure; if the salespeople in the stores are to receive $40 a week, all retail prices will have to be much higher. Our $6000 man, finding that the higher wages of other workers have taken at least half the purchasing power of his salary, will undoubtedly long for the good old days when there were many poor people who had to work for small wages.

QUESTIONS

1. What do you mean by distribution? Does each factor of production get what it produces? Does it get what it is worth, in pure competition? In monopoly? What do you mean by "what it is worth"?
2. Why is the problem of distribution more important today than it was a century ago?
3. If you accept the demand and supply theory of wages, what remedies for low wages seem most obvious? Does the marginal productivity theory emphasize somewhat different remedies? Is a reduction in the number of laborers indicated by both theories?
4. Will an increase in the supply of efficient entrepreneurs benefit all the other three factors? Will an increase in the efficiency of *any* of the factors benefit the rest? Why? Analyze each case carefully.
5. "Demand and supply work in a peculiar manner in the determination of wages. In wheat, a

high price brings out a large supply. In labor, a high wage results in a small supply." Is this comparison logical?

6. An increase in prosperity causes an increase in the marriage rate, but the marriage and birth rates are low in prosperous communities. Explain.
7. Has there been a close relation between the public lands and wages in the steel mills? Between the public lands and wages of college professors? Lawyers?
8. Is it possible for wages to rise while the population is increasing? If the population continued to increase, at what point would wages cease to rise?
9. Does the Malthusian principle have any relation to wages anywhere in the United States? If the supply of carpenters, or musicians, or nurses, or farm laborers, or lawyers, or any other kind of laborer were smaller, other conditions remaining the same, would their wages not be higher? From this, would you dare conclude that if the total population of the United States were smaller, *all* wages would be higher?
10. Is it the present or the past standard of living that affects present wages more? What do you mean by "standard of living"?
11. "In estimating the cost of production of efficient labor, we must take the family as the unit." Why?
12. "History has been a race between the capitalists, in their efforts to develop wealth, and the laborers, in their efforts to people the earth. Had the capitalists done less well, the laborers would have suffered the Malthusian check; and had the laborers done less well (in multiplying), they would not be poverty-stricken today." Do you agree?
13. Marshall says that if an occupation offers a few extremely high prizes, its attractiveness will be increased out of proportion, and wages will be relatively low. Is there statistical evidence to prove this?
14. Does competition tend to equalize wages?
15. If the number of laborers in a plant is doubled and the marginal product reduced, is the productivity of all the men previously employed reduced? Do they all produce the same?
16. Why are some of the dirtiest jobs in a packing plant the worst paid? Why do assistants in a university, who have the hardest work, receive the lowest wages?
17. How can we bring the wages of the lowest class of laborers up high enough to provide a decent living, when the marginal revenue productivity of such workers is not equal to that wage? Will they have to be given more than they add to the total production?
18. "The trouble is, the higher wages go, the less the laborers will work because the less they have to work to keep themselves. Higher wages only mean fewer working days and more time to loaf." Do you agree?
19. What do you mean by the "marginal productivity" of labor in competitive industries, and the "marginal revenue productivity" of labor in monopolized industries? Is it true that in a competitive industry wages tend to be *equal* to marginal productivity? Is it correct to say that wages are *determined by* marginal productivity? Explain. In what case might we say that marginal productivity *is* the wages? For what two reasons may marginal productivity be low?
20. If men with the qualifications needed to become chancellor of a university were extremely common, and men with strong enough backs to carry a hod of mortar were very scarce, might chancellors be paid 50 cents an hour and hod carriers $10,000 a year? If so, would the chancellor's son dare to date the hod-carrier's daughter?
21. President Roosevelt planned to ask Congress to raise the minimum wage in some industries to 60 cents an hour. If many laborers are working for less than this amount, what would be some of the possible results of this increase?
22. "Women's wages are frequently lower than men's, not only because in some occupations women produce less than men, but also because, even when they produce equally, the women's standard of living is lower in that they usually do not support a family and are often not entirely dependent on their earnings." Discuss the logic of this.

23. In pure competition, labor would produce the maximum possible output and would earn the maximum possible wages. Why?
24. In what ways does monopoly *in the goods market* tend to reduce wages?
25. If all laborers were organized, could they force the wages of all labor groups up? Discuss fully.
26. If the wages of plasterers are raised far above the competitive level, it tends to lower the wages of carpenters. Why?
27. "In order that laborers may get the value equivalent of their marginal product, it is not necessary that they have bargaining power equal to that of employers; it is only necessary that there be keen competition among employers." Comment on this.
28. Why are wages higher in the North than in the South? In big cities than in small cities or towns? In large companies than in small ones?

Chapter 27.

Labor Problems

Throughout history there have been a small directing, ruling class, and a large class of workers subject in greater or less degree and in various ways to its authority. In ancient times, the pharaoh, Inca, king, or emperor held absolute power over his nation of slaves; in feudal times it was the king or nobles who, under certain regulations and restrictions, controlled the slaves or serfs who did the common work; in modern times, it is the employers who, under the wage system, direct the labor of theoretically free workers, provide them with machines and materials, and pay them wages for their work. Looking back over the sweep of centuries, we see a rise in the status of labor, although the position of many laborers is still one of subservience.

Labor problems in the past

Labor problems as we see them are quite modern. Although Plato and Aristotle discussed certain economic problems with considerable sagacity, they paid no attention to labor problems, for most of the work was done by slaves and so there were no labor problems in the modern sense. This was also true in ancient Rome, and in much of Europe well into medieval times. During the medieval period the population was almost entirely agricultural; and the few non-agricultural laborers were mostly self-hired craftsmen who sold their wares for whatever they could get, and were therefore generally unconcerned about wages. Later in that period, however, the spread of Christianity brought a change in attitude, in that slavery was condemned and the dignity of labor was recognized; while with the growth of towns and the rise of the craft gilds, labor attained a new position of freedom. The mercantilists, in the sixteenth and seventeenth centuries, were chiefly concerned with building a rich and powerful nation by various means, particularly by maintaining a favorable balance of trade and an inflow of the precious metals; and their idea of state building was hostile to the interests of labor because they favored a high birth rate and generally low wages as a means of securing the large exports needed to maintain the balance of trade.

In the early American colonies, and even in the early years of the Republic, the situation was somewhat like that of medieval times. In the southern colonies much of the work was done by slaves, and in the northern colonies there were indentured servants whose status was that of slaves for the term of indenture. The generally aristocratic philosophy of the colonists is shown not only by the toleration of slavery and indenture, but by the disfranchisement of propertyless men and by the prevailing lack of respectful consideration for labor. Even Thomas Jefferson, the great Democrat, was fearful of the growth of "mobs" of laborers in our cities if great industries were developed.

Labor's position was one of little dignity, and unhappy in other respects. The workday was twelve hours or more, the factories were dirty and unsanitary, and conditions otherwise were desperately bad, as compared with modern standards. Yet we must remember that other classes lived hard lives too, judged by modern standards. As long as there was free land along the frontier, some laborers had a means of escape from intolerable working conditions; and although there were some bitter labor struggles, labor problems, as such, never became important until after the Civil War.

The vast growth of American industry over the past century, the decline of individually owned small businesses, the shift from an agricultural to an industrial economy, the increase in size of industrial plants, the growing concentration of business control, and the increasing proportion of the people working for wages —all these factors have tended to make labor problems more important than ever before, and increasingly so with the passage of time.

INDUSTRIAL CLASS ALIGNMENTS IN THE UNITED STATES, 1880 AND 1939[1]

	Percentage of all Gainful Workers 1880	Percentage of all Gainful Workers 1939
All employees	63.1	81.2
Wage earners	52.7	54.3
Clerical and sales employees	6.5	18.3
Professional employees	2.8	5.6
Managerial employees	1.1	3.0
All enterprisers (self employed or employers)	36.9	18.8
Farmers	27.8	11.8
Business enterprisers	8.0	6.1
Professional practitioners	1.1	0.9
All gainful workers	100.0	100.0

The general shift of economic classes since 1880 is shown in the accompanying table. Striking features of this table are the percentage increases in all employees, in clerical and sales employees, and in professional employees, and the decline in all enterprisers and farmers. Today more than three-fourths of those who work for a living sell their labor to an employer.

Before taking up the efforts of laborers to organize for the improvement of working conditions, it will be well to consider what those conditions were in the past and what they are today. A brief consideration will show that although many laborers used to work long hours for wretchedly low wages and some still earn very little, conditions have improved vastly in most respects.

Wages

A hundred years ago, everywhere in the world, including the United States, most laborers in retail stores and in the rapidly increasing factories and mines received very low wages, as compared with those of today. In 1825, women and girls in Manchester, England, earned from $2.50 to $3.75 a week, and women in the Waltham cotton mills in Massachusetts earned little more. Unskilled men averaged about a dollar a day, and children of course much less. In 1801, Slater's mill in Rhode Island was reported as employing 100 children from four to ten years of age, who were paid from 12 to 25 cents a day. In the Lowell, Massachusetts, textile mills in 1845, the average wage for women was about $3.15 for a six-day week of 12½ hours a day; but board and lodging cost only $1.25. Domestic servants earned around 75 cents a week, with board and something that passed for living quarters.

Although such wages seem pathetically small, they must be considered against the background of the general economic conditions of the time. Laborers were not the only class that earned small incomes. That farmers lived meagerly is indicated by the fact that many of the girls who worked in the New England mills came from farms, where their wages were probably even lower. The farmers of a century ago, and those on the frontier even later, made only a very poor living and had to work long hours, as did also most small merchants of the time. While the workday in the mills, as elsewhere, was excessively long, the work was not generally as fast and exacting as in factories today. But some of the heavy industries required more heavy lifting, more wearing muscular work, than they do today. Since there were few labor unions and no effective labor laws to protect workers, the factories were practically absolute autocracies; but this was somewhat less serious than it would be today, because the factories were smaller and there was more of the personal element in the relationship of employer to employees.[2]

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[1] Richard A. Lester, *Economics of Labor,* p. 15.

[2] John Coolidge, *Mill and Mansion; a Study of Architecture and Society in Lowell, Massachusetts, 1820–1865.*

With the growth of scientific knowledge and improvement in technology, real wages have risen greatly, probably more than 100 per cent, since the "good old days" of a century ago; yet even in recent years a large proportion of the laborers have earned only enough for a very meager living. A study made in 1912 showed that at least 6,000,000 men, some of them married, received less than $600 a year, or $12 a week. An investigation of 2000 stores and factories in 1913–1914 revealed 60 per cent of the women and girls earning less than $8 a week, and 50 per cent of the men making less than $15. During the First World War, wages and prices rose rapidly and remained high until 1930; but in 1927–1928, half the white women laundry workers earned less than $16.10 a week, and half the Negro women earned less than $8.85. In 1931–1932, the average wage for women in Maine cotton mills was only a little over $11, and in South Carolina mills less than $8. Wages rose much higher than this after 1939, with the outbreak of the Second World War, and many laborers lived very well; but war conditions can never be regarded as normal.

Hours of labor

Hours of labor, once oppressively long, have been greatly reduced in recent years. In Pennsylvania factories a hundred years ago, even children put in from 12 to 15 hours a day, worked until, according to one report, they sometimes fell asleep while eating after a day's work. If they fell asleep at their work they were sometimes whipped with leather straps, but this was less common in America than in England. In 1832, the yearly average day in New England mills was 13 hours; by 1890 the average for the country in manufacturing industries was 10 hours, and today it is about 8 hours. While hours were thus being reduced, the average production of labor was rising steadily. It is probable that laborers in most kinds of work can produce about as much in an eight-hour day as in a longer one. For a while they can work ten or even twelve hours a day without any serious reduction in efficiency; but in the long run they lose strength and energy, and in their full productive life they produce no more, and in some cases less, than they would in the shorter day.

The reduction in hours of labor has been a blessing in all respects—in raising the standards of health and efficiency, in freeing workers from their tasks for a few hours of leisure and recreation every day, in making it possible for them to *live,* rather than merely exist. There is considerable agitation for a further reduction to six hours, or even less; but this would doubtless reduce output and therefore real wages. This would be unfortunate because most laborers need money more than additional leisure. When further reduction in hours is possible, it should come in the elimination of Saturday work and an annual vacation of two weeks or a month.

The hours of labor have been reduced, it should be noted, despite the warnings of conservative people that labor with free time on its hands would use it in "debauchery." The poor are often assumed to be very easily debauched. This notion is cut from the same cloth as the notion once widely held that children should be kept busy all the time and for their moral good should be whipped frequently, in accordance with the good old injunction: "Spare the rod and spoil the child." This may be part of the general doctrine of original sin and natural depravity, but it is entirely without validity. A few laborers, like other classes, devote their leisure time to low pursuits, and many of them, like other people, do not use it for activities of great cultural worth; yet on the whole, the increased leisure time that has accompanied the shortening of the workday has been used to build better homes and better lives.

Child labor

A sad chapter in the history of labor is that dealing with child labor. During the Industrial Revolution, more than a hundred years ago, a considerable proportion of the laborers in the cotton mills were children, some of them as young as 7, who often worked twelve or thirteen hours a day, and even longer in the rush seasons. The first legislation for the protection of children in the United States was passed in Pennsylvania in 1842 and limited the hours to ten, but it applied only to *children under 12 years of age*. Several states passed such laws before the Civil War, but they were not generally enforced, and it was not until after the end of the century that the states began to establish the eight-hour day for children under 16 and set up efficient agencies for enforcement.

In 1924 Congress passed an amendment to the Constitution authorizing federal legislation on the subject of child labor. The amendment has been submitted to the states for ratification but has not become effective because not enough states have ratified it, the opposition coming largely from the South. Exceptions to hour restrictions in the state laws are sometimes permitted in such seasonal work as canning, and the laws usually do not apply to child labor on farms. We now know that even adult men can do about as much work in eight hours as in ten or twelve, yet employers within the various states have stubbornly opposed every movement to shorten the workday for children to eight hours, using in each state the argument that such legislation would drive business concerns to other states that permit children to be exploited without restriction.

Women workers

Legislation for the protection of women in industry has followed on the heels of child labor legislation. Like men and children early in the nineteenth century, women worked twelve hours a day or more. The first law limiting their work to ten hours was passed in 1847 but, like the child labor laws, was not enforced. Many of these early laws were, perhaps intentionally, unenforceable; the Ohio law of 1852, for instance, forbade the employer to *compel* women to work more than ten hours, but if the women were *willing* to work longer the law did not interfere. Women who needed jobs were of course "willing," so the law was a dead letter. Effective legislation did not come until the 'seventies; even today, some states permit ten hours of work, and only a few have laws prescribing the eight-hour day. Most of the state legislation does not distinguish clearly between work which involves severe strain, such as the work of telephone operators, and other work which is not very exacting. In 1908 the Supreme Court upheld the constitutionality of the Oregon ten-hour law for women on the ground that the health of women, as mothers of the next generation, was a matter of concern to the state; and in 1915 it upheld an eight-hour law in California.

In many states women are still ill protected not only in the matter of hours but in working conditions. Some kinds of work, for men as well as women, are made unnecessarily tiring by the senseless demands of customers or what employers conceive those demands to be. For example, on the theory that it represents "dignified" and stylish "service," bell hops and elevator operators in hotels, waitresses in restaurants, and saleswomen in stores are required to stand for long hours, even when they have nothing whatever to do. It is safe to say that a fair proportion of the working classes must work under conditions that should not be tolerated.

One of the New Deal measures passed by Congress was the Fair Labor Standards Act, sometimes referred to as the Wage and Hour Law, enacted in 1938. This gradually reduced the standard workweek, until in 1940 it was to be 40 hours, and set up machinery designed to raise the minimum wage in industry, over a period of seven years, to 40 cents per hour. Certain industries are exempt from both the wage and hour provisions—agriculture, fisheries, local retail and service establishments, and small newspapers, among others. A few others are partly or entirely exempt from the hour provisions; these include milk processing plants, plants engaged in ginning or compressing cotton and in making raw or beet sugar, and certain other seasonal industries such as vegetable canning.

Industrial accidents

Industrial accidents take a heavy toll of workers each year. Although estimates vary widely, probably at least 20,000 laborers are killed and at least 1,500,000 are injured every year. Mining is much the most dangerous occupation, with farming, lumbering, construction work, steel and cement and paper manufacturing, meat packing, and quarrying trailing after it; none of them is even half as dangerous as mining, which, incidentally, is apparently more dangerous in the United States than in any other important country. In many manufacturing industries there are whirring machines, heavy moving objects, molten metals, electric currents, which all too frequently kill or maim workmen.

Few industrial workers have financial reserves or adequate insurance, and the tragedy of such injuries and death is something of which the comfortable, well-to-do classes have little conception. At one time, although the employer was bound to provide reasonably safe working conditions, the workman had little recourse in case of injury. He assumed the ordinary risks of the employment in which he was engaged, even when an injury was due to the negligence of a " fellow servant"; and if he sued the employer for damages he had to prove that he himself was not guilty of negligence. He could seldom afford to bring a suit of this kind, for in court the employer had all the advantages that ample financial resources afford in the tournament of the law. If he did go to court, the shyster lawyers, "ambulance chasers," who represented him often kept most and in some cases all of any damages that might be awarded.

Recognizing the helpless position of labor, most of the states have passed laws setting up safety requirements for different kinds of employment. Much later than most European countries, they also enacted workmen's compensation laws guaranteeing compensation for injuries. In some respects most of these laws are still inadequate, particularly in the administrative machinery provided, but they mark an important step forward in the protection afforded workmen. It is, however, difficult to compensate a man fully for being killed.

Occupational diseases

Some lines of work involve grave hazards to health. Many workers in the match industry at one time suffered from "phossy jaw," a horrible disease of the bones caused by the phosphorus used in the matches. As early as the 'seventies, Finland, Denmark, and France forbade the use of phosphorus, but the United States did nothing until 1912, when Congress put a prohibitory tax on phosphorus matches. Painters are subject to lead poisoning, particularly where they use the spray gun, which produces a fine mist that is likely to be inhaled; here again, some European countries have prohibited the use of lead in paint, but little has been done about it in the United States. Workers who handle hides and hair have been, and in this country still are, subject to anthrax, a fatal contagious disease. Workmen in some kinds of mining and tunneling and in some factories breathe air charged with dust, which sometimes leads to diseases of the lungs. In underwater work, building tunnels and bridge supports, workmen must work under air pressure heavy enough to keep the water out, and they are subject to what is called the "bends," which may eventually undermine their health. A newspaper correspondent at a boilermakers' convention noted the common use of ear trumpets by those in attendance. Most of the boilermakers were more or less deaf. Many occupations present health hazards of various kinds, some of which are in part unavoidable, but some of which could be reduced by appropriate legislation. Some progress along these lines has been made in most states, but on the whole the United States has never been a leader in such legislation.

Industrial accidents and occupational diseases make the average life span of industrial workers definitely lower than that of most other classes. In 1933, Dale Yoder wrote as follows on this point: "Life expectancies also indicate the disastrous effects of industrial accidents and disease. The industrial employees' expectancy at age twenty is forty-two years, while that of non-industrial group members is forty-seven years. . . . Tuberculosis, for instance, occasions a death rate from two and one-half to four times as great among industrial workers as among non-workers of the same age, and mortality due to degenerative diseases, cerebral hemorrhage, nephritis, and heart disease is from two to three times as high."[8]

Insecurity

Worse for the working classes than the danger of accidents or occupational diseases is the economic insecurity which clouds their lives, the haunting fear of sickness, incapacity, and unemployment. Few laborers are able to save enough to carry them through a long period of illness or unemployment, or to provide for themselves and their families in old age. Even if their wages are high enough to enable them to save, many of them are somewhat improvident, although much less so than is commonly assumed by those who never had to live on the ordinary workman's wages; and those who do save are usually not shrewd enough to invest their money safely. The industrial insurance offered by private insurance companies is exorbitantly expensive and in all respects unsatisfactory. The result is that catastrophes to the workman or his family—sickness, unemployment, incapacity, or the final tragedy of old age—often throw him on the private charity of relatives, perhaps his children, or the public relief roll. Haunted by insecurity all his life, he all too often suffers the distress that he has always feared.

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[8] Dale Yoder, *Labor Economics and Labor Problems,* p. 330.

The simple fact is that few laborers are in a position to provide for their own security. Only the men in the fairly high income brackets can do this individually; and not many, even of these, have been able to establish their own security in the uncertain economic conditions prevailing in recent years. Many workers let their life insurance policies lapse in the first long period of depression and unemployment. For all these reasons, if there is to be security for most workers, it must be provided by the state. Most European countries long ago moved in this direction, providing insurance against accidents, disability, occupational diseases, sickness, old age, and death; but most of the states in this country have followed rather slowly. The first nation-wide social security law was the Federal Social Security Act passed in 1935.

Sickness

Partly because of the hazard of occupational diseases, partly because of generally poor food and housing, inadequate medical service, and the various hardships that go with low incomes, and partly because of the physical wear and tear of some factory work, the health of industrial workers compares unfavorably with that of most other classes; but the remedy for this is not easy to find. More careful regulation of factories, covering dangerous work and hazardous working conditions, heating, ventilation, sanitation, and the elimination of dust and poisons would be of some benefit; but the workers' health cannot be brought up to that of the more favored classes without higher incomes and better food, clothing, housing, recreation, education, and medical service.

Old age

Cicero's *De Senectute* gives a picture of the joys of old age which does not fit the situation of most of our old industrial workers. According to the Federal Social Security Board, about two-thirds of the people 65 years of age and over are dependent on others for support, on children, other relatives, or on public charity. Many industrial workers, however, are "old" before they reach that age, and unable to find work at which they can support themselves. Modern industry increasingly demands young men and women. Some concerns will not employ unskilled labor over 35 years of age, and in some kinds of work it is difficult for people over 40 to get a job, and in some cases to hold one. Employers prefer not to hire older men because they lack strength, endurance, and adaptability, and because they involve a greater expense under certain insurance and social security provisions. Here we see how such a law as the Social Security Act, intended to benefit the working classes, may impose a hardship in ways that are not foreseen.

Something has been done about old age security. For years the federal government has provided retirement pensions for civil service employees, assessing them for part of the cost during their working years; many states and cities provide some form of retirement allowance for teachers; and a few employers have set up pension plans for their employees, although not all of them have lived up to these plans with strict fidelity. The Social Security Act, as amended in 1939, provides for a system of annuities for all workers over 65 years of age in certain lines of industry, the workers contributing part of the cost of building up the fund from which these annuities are paid. Like the unemployment insurance provisions of this act, the plan does not cover all workers; but for those covered it does provide a minimum of from $10 to $85 a month, and also modest payments for certain dependents and survivors in case of the beneficiary's death. It thus provides at the same time old age insurance and life insurance. Particularly wise and commendable is the fact that the workers help to pay for their security, receiving the annuities later as a matter of right and not of charity, and regardless of any other income they may have. It should be expanded to cover the workers not now covered, and it should grant somewhat higher payments for the lowest income group—ten dollars a month does not provide a very rich life for an old man or woman.

The federal government has done more than this. Under the Social Security Act, it pays the states one-half the cost of any old age pensions that they provide, up to $40 a month—$20 from the federal government—for each recipient. All the states have accepted these terms, but the average pension is only about $20, and in some states it is as low as $7.87 a month. Unfortunately these federal-state pensions are granted as charity, and only to those who have no other income. It would be better if all the workers contributed to their state pension fund during their working years and then received the pension as something that had been paid for, rather than as charity. Charity often undermines the moral fiber of those who receive it.

Unemployment

During the depression of 1929 to 1939, unemployment assumed the proportions of a national calamity. Accurate figures are lacking; but according to estimates, the totally unemployed for the various years from 1931 to 1940 varied from 6.4 million to nearly 15 million, not including those employed on relief projects. To get a clear idea of the total, we should add nearly 50 per cent to these figures to include the partially unemployed during these years. One authority estimates that from 41 to 47 per cent of all the available hours of labor were lost because of unemployment between 1932 and 1935.[4] Some of these workers were unemployed for four or five years or even longer, and in so extended a period of unemployment many of them lost their health, spirit, and hope, and were no longer good workmen when they finally did find jobs.

The persistence of widespread unemployment since 1929, relieved only by our shift to a war economy in 1941, suggests the clear possibility that private enterprise may never be able to provide even approximately full employment in the future. In 1937, a year of fairly high business activity and the most prosperous one between 1930 and 1940, nearly 9 million workers were still totally unemployed. The general employment situation at that time is indicated by the following estimates of the Temporary National Economic Committee:[5]

Population, 15 to 74 years old	93,063,000
Persons employed or available for employment	54,474,000
Totally unemployed	8,928,000
Emergency workers	2,055,000
Partly unemployed	5,550,000
Part-time workers (not wanting more work)	1,190,000
Fully employed	36,079,000
Ill or voluntarily idle	672,000
Persons not available for employment	38,589,000

Industrial productivity has increased so much in recent years that, according to some estimates, if today we should maintain only the production level of 1929, the highest in our history before the war, there would be 15 million unemployed workers. To put this in another way, we must produce, and consume, much more than ever before if we are to have full employment.

In the problem of unemployment we see one of the harshest aspects of modern capitalism. In the simpler economy of a century and a half ago, most labor was self-employed, and each man's fortunes could well be said to depend for the most part on his own efforts and enterprise. If he failed to make a living, the fault was largely his own. But in our more complicated economy of today, few laborers are self-employed and the fortunes of most workers depend largely on someone else. Employment depends on the confidence employers must have if they are to provide jobs. If employers have confidence, then the working people will have jobs and wages, food and clothing and a few luxuries; but if they lack confidence, many laborers must sit in idleness until confidence returns. Inevitably laborers who can find no work, perhaps for several years, will begin to ask—in fact, they have begun to ask—why this must be, why their jobs and all that is worth while in life must depend on the state of the employer's mind.

Causes of unemployment. The successful operation of a democratic regime calls for mutual understanding and sympathy on the part of the various economic classes; yet few of the well-fed classes have much understanding of the laboring people, their lives, habits, character, purposes, ideals and aspirations, or of the problems that most of them must solve. In perhaps no other field is this lack of understanding more unfortunate than in unemployment. Some of the "bourgeoise" classes believe that most of the unemployed are lazy bums who do not really want work and would not try to keep a job if they had one. There is a modicum of truth in this. A few of the unemployed *are* not very efficient or energetic; a few who have been without jobs for a long time have lost their health and strength and hope and ambition, perhaps finding in drink an escape from their troubles or, after months or years of fruitless rounds of the employment offices, resigning themselves to the relief rolls. Unemployment, if protracted, is a spirit-breaking experience. The surprising thing is that the unemployed stand up as well as they do. Most of them want jobs, want to work, want to be self-supporting members of the community. All the investigators are agreed on that.

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[4] See Richard A. Lester, *Economics of Labor,* p. 371.

[5] *Hearings,* Part I, p. 251.

Even in fairly prosperous times there is some unemployment. There are always laborers who are not fitted to the kinds of work available; there are shifts in the geographic demand for labor which leave workers in certain regions unemployed and create a labor scarcity in other sections; some kinds of work are necessarily seasonal, as for instance fruit picking, canning, ice cutting, logging and lumbering, wheat harvesting, and building. Technological changes are constantly throwing laborers, including highly trained workers, out of work; and for some of them to find new jobs and become adjusted to new kinds of work may take as long as a year or two, if not longer.

Recently we have been mainly concerned with unemployment arising from a different cause—the widespread, persistent unemployment incident to cyclical depressions, if the depression of the 'thirties can be called a cyclical depression. As we have seen, there is always considerable unemployment in the recession and depression phases of the business cycle; but during the dark years of the Great Depression the figures soared higher than ever before. Why, after two or three years of deep depression, was it impossible for millions to find jobs? The obvious and superficial answer is of course that employers did not feel enough confidence in the business situation to resume operations and hire labor again, did not see a reasonable certainty of being able to sell their output for enough to cover costs of production. Is it possible that the high costs were due partly to high wages, for wages tend to lag behind prices in the cyclical downswing as in the upswing? The answer is yes; for high wages, not of all labor but of strongly organized labor, may delay the resumption of business operations. The wages of building craftsmen remained high for several years after the depression struck, so high that entrepreneurs could not afford to do much building; they could not sell houses for enough to cover costs. This situation prevailed in a considerable number of industries for several years after the onset of the depression. The high wages paid a few well-organized groups thus reduced the amount of employment for all labor. In some industries wages constitute a goodly share of the total costs.

It would be easy, however, to stress high wages too much in connection with unemployment. The demand for labor is usually a joint demand, and even a considerable reduction in wages may not reduce costs very much. Furthermore, in the all-pervading pessimism of a deep depression most businessmen would hesitate to resume production, whatever the rate of wages. Even if we grant that wage reductions help to revive business and increase employment, we must recognize that there is some justification for labor's unwillingness to reduce wages promptly, for labor knows that it is difficult to get wages up again when prosperity returns. Moreover, wages are not the only cost that is tardy in adjusting to lower prices. In the building industry, for instance, the prices of many materials are controlled by monopolies which may reduce prices slowly or not at all; nor do creditors scale down their claims, they insist on their pound of flesh. Lower wages would help; but there is no good reason why labor should be expected to assume more than its share of the burden of cost reduction.

Unemployment insurance

Various schemes have been tried by different countries to alleviate the distress arising from unemployment. Under the Ghent system, adopted in many European countries, the government, usually the municipal government, grants subsidies to trade unions which provide unemployment insurance. This system has brought an expansion of unemployment insurance, but it is defective in two respects. In the first place, unless all the labor in a country is unionized, the benefit is not extended to all; and in the second place, since it calls for no contribution from the employer, it gives him no strong incentive to keep unemployment as low as possible.

Compulsory unemployment insurance was first provided for in England in 1912 and has since been adopted in several other countries. The British plan provides insurance for most kinds of workers, the employer, the employee, and the government contributing to the insurance fund. Since the benefits are paid to workers for only twenty-six weeks in the year after unemployment begins, the law does not meet the needs of people who are out of work for several years.

The first unemployment legislation in the United States was the Wisconsin Unemployment Reserve Act of 1932, which became effective in 1934. On the theory that employers could prevent unemployment if they were taxed for the relief of unemployed workmen, the Wisconsin law provided for contributions only from employers, who were required to build up individual reserves for the payment of unemployment benefits but were accorded tax reductions or exemptions when their reserves reached a certain percentage of their pay rolls. This law had been in effect only a year when the Social Security Act was passed.

The Social Security Act provides for a 3 per cent federal tax on the pay rolls of employers hiring eight or more workers in certain lines of work, the employers being permitted to deduct from this tax any amounts, up to nine-tenths of the federal tax, that they have paid into a state unemployment fund provided under a state law approved by the Social Security Board. Certain classes of workers are exempted from the law—agricultural and domestic labor and those who work for the government and for non-profit organizations. This law forced the states to provide unemployment benefits, because any state which failed to do so would be committing the folly of denying its workers the benefits of the payments for which employers within the state were being taxed. Since the law applies to the entire nation, it subjects employers in all states to the same burden and so meets the objection urged against all state laws, that such a tax handicaps the employers within one state in competing with those in other states which do not levy it. Some freedom is left to the states as to the details of the laws and their administration, in order to encourage experimentation; and some of the states, following the Wisconsin tradition, are experimenting with schemes for "experience rating," by which tax reductions are allowed employers with stable employment records; but the results of this are not yet clear.

Experience rating has been debated a great deal by labor economists. European laws do not provide for any distinction among employers on the basis of their employment records; and there is doubt as to its wisdom. In the first place, the plan seems to rest on the theory that individual employers are at least partly responsible for unemployment and that they could keep more people employed if there were sufficient inducement to do so. Some employers could doubtless manage to keep a few more workers employed; but the causes of unemployment are generally beyond the employers' control. In the second place, tax reductions for employers with stable employment records might tend to discourage them from expanding their working force in prosperous times, lest they have to spoil their record by dismissing labor in slack periods.

Many perplexing questions arise in the administration of unemployment insurance. A person is unemployed when he is able and willing to work and cannot find a job; but just how shall we interpret the phrase "able to work"? In every society there are gradations of ability, from the young, strong, capable, and well-trained workers to those who are clearly too old, too weak and decrepit, too incompetent, perhaps too dull, to hold down a job—the unemployables. How old, weak, decrepit, incompetent, or dull must a worker be to be ruled out of the class of employables? Clearly no definite line can be drawn, yet administrators must make such decisions, with whatever wisdom they can command.

It is also often difficult to decide on the exact meaning of the phrase "willing to work." Is a carpenter unwilling to work when he refuses a job as a farm laborer? Or a violinist if he refuses a job as a hod carrier? Suppose a man quits his job because the union has gone out on strike. Suppose his union leaders order him into the picket line. Is he unwilling to work if he refuses to work as a strikebreaker? Is he unwilling to work if he refuses a job a thousand miles away from home? How long must he be unemployed before we can insist that he accept a job in a type of work that is new to him? How much of a reduction in wages should he be willing to take? These are not merely hypothetical questions; unemployment agencies must answer them every day in the week.

Government employment

Insurance is not a *remedy* for unemployment; at best it is only a palliative. The only remedy for unemployment is employment, jobs; and there is a trend, the world over, toward the view that if private enterprise cannot provide jobs the state must. The Fascist governments of Germany and Italy, although hostile to the laboring classes, did provide jobs—at low wages indeed, and under conditions not far from slavery, yet jobs which meant security; and many democratic countries have also ventured into the field of government employment.

Why cannot the government provide jobs in depression times and then retire from the field when prosperity returns and private employers are ready to take over? Theoretically this should be possible, and a wise dictator might be able to make it work; but a fumbling democracy is likely to find such a policy difficult to carry out successfully. For one thing, private business interests will not permit the government to produce goods that private concerns have been producing, such as shoes, clothes, refrigerators, radios, and cars—the things that people want most. They have sometimes conceded to the government a part of the field of slum clearance and low-cost housing, which is not very profitable for private builders; apparently private builders cannot build homes for low-income families at a cost that such people can pay. As a rule, the government is restricted to the fields of production which private business does not want or for some reason cannot claim, particularly public works of various kinds, such as post offices, schools and other public buildings, reforestation, land reclamation and recreational projects, hydroelectric plants, and the like. Reforestation and land reclamation are urgently needed, and there can be no objection to the employment of labor at such work, but it requires mostly unskilled labor. The federal Civilian Conservation Corps engaged largely in this kind of work during the Great Depression, and the project was generally regarded as successful. Most of the members of the CCC were unemployed young men who not only did very useful work but improved their health and morale while doing it.

Public buildings may also be useful, but their construction calls directly for the building crafts, which are strongly organized and are likely to demand unreasonably high wages, in some cases the "union scale." There is a danger too that in erecting public buildings the government may sometimes go too far and build, or help build, "white elephants" that local communities will find it difficult to maintain later. There are a few memorial halls in the country, built under the Public Works Administration, which the local taxpayers would gladly trade for statues, which could be more cheaply maintained. If they are needed, hydroelectric plants, such as the Grand Coulee Dam and the Bonneville Dam, represent a wise use of unemployed labor which would otherwise be wasted; but since they produce electricity in competition with private plants, such projects are opposed by privately owned utilities. It is said that the latter are largely responsible for the fact that no great hydroelectric dams have been built in the New England states.

A program of public works may fail to hasten the reemployment of labor by private industry, or may even retard it. The government is almost certain to interfere with economic adjustments which must be made before private business can go ahead. One of these adjustments is usually a reduction in wages. Under pressure of the labor vote, the government is likely to pay the prevailing union scale of wages, hire labor away from private employers, and so reduce the amount of private employment. In some cases the government did just this, under the New Deal. Furthermore, the government is not generally an efficient or energetic "boss," does not push labor very hard, and hence is likely to encourage slack habits. Perhaps if it were given a period of years in which to build up a working organization, it might do fairly well; but depression-time "made work" is likely to be done inefficiently and wastefully and it does not prepare labor for the more exacting demands of private employment. If labor is to be encouraged to shift to private jobs, the terms of employment in government work must be made less attractive than those which private employers are expected to offer; but this is difficult to manage if there are a great many unemployed workers, because the unemployed control a formidable block of votes. Experience with the relief work under the New Deal proves that it is difficult to manage this shift from government projects to private employment. If the government adopts the policy of guaranteeing jobs whenever a depression strikes, it is likely to find itself, for better or worse, the regular employer of a considerable portion of the country's labor.

QUESTIONS

1. Where wages of labor are very low, is it likely that the incomes of farmers and many other classes will also be low? Why or why not?
2. What is it that has raised the wages of labor so greatly since colonial times? What is it that has brought reduction in hours of work? Do laborers generally use their increased leisure for dissipation?
3. Why should women in industry be protected more carefully than men? That they have greater vitality is shown by the fact that their life expectancy is several years longer than that of men.
4. Would not self-interest lead an employer to provide safe conditions for his working force, since by doing so he could attract labor more easily to work for him, or could attract a better grade of labor? Explain.
5. Name some common occupational diseases. Why are laborers willing to work where such diseases are common? Why do some European countries guard against them better than we do?
6. What are some of the causes of unemployment? Why is it a more serious problem today than it was a century or even half a century ago? Did labor unions have any responsibility for the long period of unemployment in the early 1930's?
7. What provisions of the Federal Social Security Act of 1935 are designed to alleviate the hardships of unemployment? Do you think it a wise measure? Does it meet the real need for *jobs*?
8. What are some of the difficulties in the way of government employment for the unemployed? Where should wages be fixed for this work?
9. Is a government minimum wage law to any extent a remedy for low wages? What are some of the possible results of such a law? What would be a real solution of the problem of low wages?
10. How can you justify the common discrimination against Negroes in industry? What can be done about it?
11. Steel workers are now demanding an "annual wage"—a certain amount of pay each year no matter what business conditions are. Would this add to the rigid elements in our economic system and perhaps make depressions worse, or would it reduce the severity of depressions by keeping purchasing power up? Would there be any difference if it applied to only a few industries or to all?

Chapter 28.

Labor Unions

History of labor unions in the United States

Labor unions date from the earliest years of our national life, but, until about 1830, they were small, local, and unimportant, and usually broke up in every depression. In the United States as in England, these early unions encountered the hostility of the courts, which generally held them to be unlawful conspiracies. With the spread of the Industrial Revolution to this country in the period before the Civil War, a labor movement tinctured with idealism, reform sentiment, and even a modest amount of radicalism gained considerable momentum. Some of the unions demanded not only shorter hours but public education, the suppression of monopoly, cooperation, mechanic's lien laws, and free homesteads; and there was some opposition to compulsory military service and imprisonment for debt. Some even showed an interest in the utopias inspired by the French utopians, Cabet and Fourier.

After the Civil War the labor movement turned generally to more practical objectives, particularly to the demand for an eight-hour day; yet in the great outstanding labor movement of this period, that of the Knights of Labor, there was a demand for various economic reforms. The Knights of Labor was a highly centralized national organization the promoters of which tried, without great success, to include all the labor unions in the country. It finally attained some 700,000 members in 1886, after waging successful strikes against several railroads; but after its defeat that year in a strike on one of the Gould railroads it began a rapid decline in power and membership.

With the decline of the "reform" unionism of the Knights of Labor, a different type of union came to the front, the business unions, which, as later organized into the American Federation of Labor, remained the dominating national organization until recent years.

The American Federation of Labor demanded "more now" for labor, and employed businesslike methods to secure it—strikes, boycotts, picketing, and trade agreements; but it represented mainly the "upper crust" of the workmen, and later adopted a rather conservative policy that was little concerned with organizing the great body of unskilled labor. Partly as a result of this, the radical and even revolutionary labor federation known as the Industrial Workers of the World (the I.W.W., or "Wobblies," as its members were often called) was organized in 1905 by some of America's most picturesque labor leaders, among them "Big Bill" Haywood and "Mother" Jones. The I.W.W. represented a motley assortment of radical philosophies—communism, socialism, anarchism, and syndicalism—and it suffered from internal dissension from the start. Because of its emphasis on direct action, which often meant violence and destruction, it met strong official and public hostility; and when it tried to interfere with the prosecution of the war in 1917, the federal government cracked down on 100 members, sent most of them to the penitentiary, and practically broke up the organization. After the war, revolutionary unionism was taken over by the communist unions.

Union membership fluctuated with the ups and downs of business, growing in periods of prosperity and declining in hard times, but rising generally, particularly from 1894 to 1920. In the latter year, more than 5,000,000 union members were reported, but the depression of 1921 caused heavy mortality in the union ranks, from which there was little recovery until about 1933.

In 1932 the situation of labor seemed desperate indeed, for the country was in the depths of the worst depression in its history, with something like 15 million men unemployed. The Hoover administration and a conservative Supreme Court were generally hostile to labor, and the American Federation of Labor was suffering from apathetic, conservative, and incompetent leadership which was unequal to the problem of adjusting to changing industrial and labor conditions. The A.F. of L. was a federation largely of *craft unions*—unions of workers skilled in the various crafts—and under the impact of developments in mass production the importance of craftsmen was declining rapidly. In the great automobile plants, for example, where the assembly line and mass production dominated, skilled craftsmen were being largely displaced by semi-skilled and unskilled workers. The A.F. of L., with its strength based largely on craft unions, was not well fitted to organize such industries, if indeed its officers had any interest in doing so. The automobile, steel, and some of our other great industries needed *industrial unions*—unions that would include all production and maintenance workers in each industry—and the A.F. of L. officers were either unable or unwilling to undertake the task of building up these unions. There was some justification for their hesitation. Our vast automobile industry was controlled by a few giant concerns that were strongly hostile to labor unions; the steel industry had always maintained an impregnable defense against unionization; and the millions of unemployed made it seem an inauspicious time for an organization drive.

On the other hand, the government under Franklin D. Roosevelt was extending a friendly hand to labor. The National Recovery Administration organized business on an industrial basis, and proved a powerful stimulant to labor organization on the same basis; and the assurance of federal relief for laborers on strike encouraged a militant policy. The A.F. of L. expanded its membership considerably but, jealous of its craft union prestige, did little in the field of industrial unionism. Accordingly, late in 1935 the presidents of eight powerful unions, under the leadership of John L. Lewis, president of the United Mine Workers, formed the Committee for Industrial Organization to launch an organizing drive on the industrial basis. This precipitated a bitter row with the A.F. of L.; but the C.I.O. (later the Congress of Industrial Organizations) went ahead and, in the most spectacular organization campaign in the history of labor, added some 4,000,000 members to union ranks. In this campaign the C.I.O. had to fight not only employers' organizations but to some extent the A.F. of L. as well; but labor had the support of the government, which through the National Labor Relations Board was actively supporting the organization movement. Within a little more than a year the C.I.O. had organized all the automobile workers except those in the Ford plants, within another year the United States Steel Corporation had capitulated, and later Ford admitted the organizers to his plant; but "Little Steel," which included some of the smaller steel companies, used propaganda, labor spies, strikebreakers, police, and national guardsmen, and successfully resisted the organizers in bloody labor battles in which a number of strikers were killed. In 1939 the A.F. of L. and the C.I.O. each claimed about 4,000,000 members, and by 1945, this had risen to approximately 6,000,000 each.

Ends sought by labor unions

Labor unions are organized for the general purpose of securing certain advantages for labor: union recognition, higher wages, shorter hours, and better working conditions. A union's first task is to secure recognition from the employer, that is, to persuade or compel him to deal only with the organized workers. This is often a tough job, one that may call for a long and bitter struggle, and perhaps a strike, which may result in violence and bloodshed. A large proportion of strikes are called for the purpose of forcing recognition of the union. After recognition has been achieved, the next step is the formulation of a trade agreement, with clauses that cover standard wages, hours, and working conditions. Although wages are not the same for all classes of workers, they are uniform for workers within each class. The union's insistence on standard wages, hours, and working conditions is often criticized by the public as tending to set a dead level of performance on the part of the workmen; but if variations were allowed, employers might gradually break down the entire agreement by nibbling at one item after another, making exceptions here and there.

The closed shop. Unions rightly regard the closed shop, that is, one which hires no nonunion workers, as essential to collective bargaining. This is opposed by many employers and is regarded as arrogant usurpation by many people; but granted that labor organization is justified, the closed shop is also justified, for two reasons. In the first place, only if all the workers are members can the union leaders call out the entire force and make a strike effective. In the second place, wages and working conditions are usually better in union shops; and it is only fair to require the employees who benefit from the union's protection to contribute in money, time, and effort, for it costs something to maintain the union which is responsible for these conditions.

Most labor economists agree that the closed shop is justified if the union itself is open, that is, open to all who wish and are qualified to join. Unreasonable obstacles to entry, such as overlong apprenticeship requirements and high entry fees, characterize closed unions. A closed shop and a closed union constitute a monopoly which cannot be justified.

The checkoff. Labor unions sometimes go further and insist on the *checkoff*. Under the checkoff, the employer deducts the union dues from the employees' wages and turns them over to the union treasury. This may seem rather highhanded on the part of the union, but it simplifies the problem of collecting dues; and if labor unions are justified, the checkoff may be justified as a means of making the unions effective.

Labor union weapons

The strike. Labor unions use various weapons in their struggle with employers, the *strike* of course being the most important. If the workers cannot get the employer to recognize their union or conclude a satisfactory trade agreement, or if there is a dispute that cannot be settled peaceably, the union leaders may call a strike, that is, order all union workers to leave their jobs. This step is usually not taken without careful consideration, for a strike is an expensive form of warfare at best, since it means cessation of wages for the workers, perhaps for a long time; and at worst, if unsuccessful, it may wreck the union. Many a union has been broken by a strike that failed. The strike is more likely to succeed if the workers are organized on a national scale, for in that case members outside the strike area can contribute something to those on strike; or the national union, or federation of unions, may have a war chest for the support of striking members. A strike is also more likely to be successful if the striking union is tied in with other unions in allied crafts or fields of industry, for the allied unions may call "sympathetic strikes," and so bring additional pressure to bear on the employer. Musicians and stage hands sometimes cooperate in this way.

When a union goes on strike, it does not leave the premises and wait for the employer to hire another force. Workers commonly regard their jobs as their own, as something in which they have a "job right," a sort of property right; and they try hard to keep other workmen from taking their jobs. While on strike they "picket" the shop; that is, they post a few of the striking workers at the entrance of the plant to try to dissuade scabs from taking the jobs. These pickets parade back and forth carrying big placards, "Unfair to Labor," and perhaps arguing with any who try to enter. Peaceful picketing has been held legal, but sometimes it is difficult to keep it peaceful.

The boycott. Another union weapon is the *boycott*, the organized refusal of the workers and their sympathizers to buy the employer's products. At one time some unions used the *secondary boycott*, which is a boycott not only of the employer but of other employers as well unless they also boycott him. The scondary boycott has been held illegal.

Sabotage. Labor unions have sometimes used *sabotage* as a means of bringing an employer to terms. This calls for deliberately slowing down work, wrecking machinery, spoiling raw materials or finished goods, misdirecting movements of goods or materials within the shop or to customers, and even bombing the plant. Moving-picture operators and a few of the building crafts have occasionally resorted to bombing. Since much sabotage is carried on secretly, it is not known how much there is, but any is too much.

Politics. In recent years, labor unions have turned to *political weapons* against organized business. The American labor movement has generally been non-political, but the C.I.O. contributed nearly $500,000 to the Democratic party in 1936, and in 1944 it set up a Political Action Committee, with a fund reported at $700,000, to carry on a fight against some of the reactionary, anti-labor candidates for public office. The P.A.C.'s extraordinary success in helping to defeat several anti-labor candidates for Congress created a tremendous outburst of indignation on the part of wealthy employer interests that had previously enjoyed a near-monopoly of the business of financing political propaganda. Some of them insisted that the work of the P.A.C. was a violation of the Smith-Connally Act, which had been passed to prevent labor unions from making political contributions, and the Attorney General ordered an investigation. Men who give as much as $50,000 to political campaigns find American democracy in great peril when C.I.O. members contribute an average of less than 15 cents each!

Obstacles to labor organization

In their efforts to organize workers, labor unions have encountered formidable obstacles. For one thing, the theory of labor unions and collective bargaining runs counter to the tradition of "rugged individualism" which still dominates the thinking of many Americans, particularly the business classes and the farmers. In some parts of the country people look back only two or three generations to pioneer days, when every man was assumed to be the master of his own destiny, when cooperative action was resorted to only under exceptional circumstances. Most farmers, small merchants, and people of the middle class have little conception of the position of the individual laborer in a great industrial concern. "If a man doesn't like his job, let him quit and get another, instead of ganging up on the employer, striking, picketing, and trying to keep other men from working" is a fair expression of the creed to which many people hold.

Such a hostile view comes more easily to the general public because in most labor struggles the laborers seem to be the aggressors, the ones who are causing the trouble. Employers do not usually appear as the instigators of a labor contest; they need only sit tight and refuse to negotiate. The great weapon of the unions is the strike, and strikes often cause considerable public inconvenience for which the unions are likely to seem responsible, no matter how well justified they may be. Strikes always involve the possibility of violence, and many people are inclined to chalk this up to the unions, because even when the employers are largely responsible they are frequently able to hide their own part in it.

Labor union evils

Restriction of membership. Unfortunately, labor unions sometimes merit public hostility, for some of their policies are selfish and inconsiderate of the public interest. Thus some unions try to maintain monopoly scarcity of labor within their trades by restricting entrance into them. This is done (1) through apprenticeship regulations, such as limiting the number of apprentices; (2) through regulations limiting the use of helpers, since helpers may learn the trade and so swell the number of workers; (3) through the fostering of legislation requiring licenses to engage in various trades—a fairly common practice on the part of plumbers, stationary engineers, firemen, electricians, barbers, and taxi drivers; and (4) through the imposition of high initiation fees—from $200 to $500, and as high as $600 in a few trades. There is an element of justification for some of these policies, but most of them represent a selfish effort to establish monopoly scarcity of workers.

Make-work rules. Unions often develop other vices quite as bad as restriction of numbers. Some of them have adopted make-work rules designed to provide more work for their members. A few unions limit the *amount* of work that a member may do. The Chicago lathers' union, for instance, defined 100 yards of wood lathing as a "fair day's work"; plasterers sometimes limit the amount of lime that may be handled in a day; and bricklayers sometimes limit the number of brick to be laid. In some cases, pieceworkers (laborers paid on the basis of the amount of work turned out, not on a time basis) make informal agreements not to earn more than a certain wage. There may be some justification for such rules, for unorganized laborers have at times been driven at speeds injurious to health; but some restrictions set the output so low that efficient workmen can loaf on the job a great deal. Particularly is this true where machinery is being improved steadily to make greater output possible.

In some cases the unions set limits to the *speed* of work. The longshoremen (the workers who load and unload ships) on the Pacific coast regulate the size of the "sling load." Similar limitations are common in the building trades. For example, bricklayers have been forbidden to use both hands in laying brick or to use any other tool than the trowel lest they be able to lay too many bricks; plumbers were at one time forbidden to ride a bicycle from one job to another because they saved too much time that way. Laborers generally have a strong hostility to pace setting, and even to an employer's efforts to keep track of the time each worker spends on a job. Speed limitations, like limitations on output, tend to establish uniformity in performance, to reduce all the workers to a certain level, to prevent the highly efficient laborers from doing their best; but reasonable limitations are not altogether without justification, which is not to say that limitations are always reasonable.

Some unions, particularly in the building trades, maintain rules requiring *time-consuming methods* of work, which may consume time by reducing speed or in other ways. Painters' unions have at times forbidden the use of brushes more than four and a half inches wide; plumbers, carpenters, and plasterers have banned various time-saving methods and devices. Many of the building trade unions require that certain tasks be done on the job which could be done much more efficiently in the shop or factory. Thus the hod carriers' union in Chicago prohibits the use of ready-mixed concrete, and the lathers' union in New York refuses to install metal lath and metal rods which are not cut and bent on the job or in union shops, although these processes could be done more cheaply in the factory. The plumbers in Houston, Texas, require that piping which has been cut and threaded for a particular place in a specific job must be cut off at the end and a new thread cut on the job. Many plumbers' unions have forbidden the use of assembled plumbing supplies, or the installation of fixtures partly put together at the shop or plant. Chicago painters require that sashes, frames, and screens must be primed, framed, and glazed on the job, at a much higher cost than would be necessary in the shop or factory. Painters have refused to work on cabinets that were partly finished at the factory. "A painters' union, under threat to picket on the opening night, forced the owner of an ice arena in Cleveland to hire union painters to run dry brushes over the seats for a few days prior to the opening of the arena, because the seats were purchased already painted from an out-of-town firm."[1]

In some instances, labor unions try to make work by requiring that *unnecessary work* be done, or that work be done more than once. Printers in certain cities have maintained the "dead horse" rule against the use of "borrowed matter"; that is, any advertisement set up in one newspaper shop cannot be run in another newspaper without being completely reset. During the construction of one government building in Washington the painters refused to apply a resinol base paint because only two coats would be required, instead of the usual four coats required with lead and oil paint.

Fairly common make-work rules are those requiring that an *unnecessarily large number of men* be employed to do a given task. "The hoisting engineers in New York City insist that when steam for power is obtained from pipe lines under the streets, three shifts of engineers must be employed, although all they have to do is to watch the valve. This can be turned on just as well by someone else. Some locals of the electricians require that, when temporary lighting is used, an electrician be constantly on the job even though he has nothing more to do than turn off the lights when the other men are through work. A coal mine in northern West Virginia had an electric pump with an automatic switch which required attention two or three times a day. The mine committee demanded that an attendant be employed and that the foreman be forbidden to give occasional attention to the pump."[2] Motion-picture operators have tried to force employers to hire two operators for each machine, and truck drivers' unions have often insisted on a rule requiring that under certain circumstances two drivers shall be hired for each truck, although there is little or nothing for the second man to do. Unions of stage hands and musicians have various regulations requiring the employment of crews and orchestras of a certain size, in many cases larger than necessary. Musicians' unions, which are among the most arrogant of unions, have even demanded that "stand-by" orchestras be hired when there is absolutely nothing for them to do, as when amateur orchestras broadcast over the radio or a station is receiving remote control programs.

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[1] Richard A. Lester, *Economics of Labor*, pp. 142–143.

Railway unions have forced the operators to hire thousands of unnecessary employees. In many states they have secured "full-crew" laws, which specify a certain number of men on trains, and in a few states they have obtained the passage of laws limiting the length of trains. The railway brotherhoods have many other rules which heavily increase the number of workers that must be hired. One of the most important of these relates to the method of figuring wages for trainmen. A day's work for an engineer or fireman is defined as 100 miles *or* eight hours in freight service, and 150 miles *or* eight hours in passenger service; that is, a freight engineer or fireman receives a day's pay if he runs 100 miles or if he works eight hours no matter how far he travels. This standard was set when trains ran little more than half as fast as they do now, and the result is that engineers and firemen earn their day's wages in four or five hours, and sometimes in as little as three hours or less; this means that the railroads are obliged to hire thousands of workers who are not needed. The exactions of the railway unions is one, but not the only reason for the desperate financial condition of most of the railroads in recent years.

Unions sometimes make work by requiring that work be done by *members of a given skilled craft*, although it could be done as well by unskilled or semi-skilled workers. "Some locals of the plumbers' union require that distribution of plumbing materials above the first floor shall be made by union plumbers. Structural steel workers require that steel be brought from the unloading point to the building site by their members and that re-inforced steel for concrete be placed by them, though laborers could do the work. Bricklayers demand that only bricklayers wash down and point brick. The carpenters in many cities demand that stripping forms from concrete be done by their members. Rule 55 in the national agreement between the United States Railroad Administration and the shopcraft unions provided that the dismantling or scrapping of engines, boilers, tanks, cars, or other machinery should be done by mechanics of the respective crafts." Railroad unions have a great many rules designed to establish the principle that every piece of work in the operation of a railroad "belongs to some particular class of employee and, in effect, is *owned* by that class," however great may be the unnecessary expense to management in applying that principle.[3]

Unions often make work by *prohibiting employers or foremen from working on the job.* Like a great many other oppressive policies, this is fairly common in the building trades. Under certain conditions there is justification for such a rule, for some employers have evaded union agreements by making several of the laborers foremen, thus removing them from union protection and perhaps working them overtime without extra compensation; but in other cases it adds unnecessarily to production costs. Union rules must apply generally, like all administrative rules, for exceptions are likely to lead to their evasion and breakdown; but such rules almost inevitably have some unfortunate consequences.

Designed to increase employment, yet generally justified, are the union rules controlling the *quality of work,* which require that work be done in "thorough and workmanlike manner." Such rules are most common in the building trades, for many contractors in certain types of construction have tried to skimp on work. Rules to prevent this seem generally commendable, although, as Slichter suggests, such rules applied to the observance of specifications and building codes are more important as a source of graft for union officials than as a means of increasing employment.

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[2] Sumner H. Slichter, *Union Policies and Industrial Management*, pp. 183–184. By permission of The Brookings Institution, publishers.

[3] *Ibid.*, pp. 192–196. By permission of The Brookings Institution, publishers. In this chapter, particularly in the discussion of union policies, the author has relied heavily on Slichter's book.

The most important of the make-work rules perhaps are those designed to *protect labor from the impact of technological changes,* from the effect of new labor-saving machinery and methods. Employers in competitive fields are constantly driven to seek new, cheaper, and more efficient methods of production, and such methods often tend to displace labor. Instances of this, and of union opposition to such improvements, are too numerous to be discussed at any length here. In coal mining, electric drills and cutting machines; in cigar making, the shift from handicraft to machine production; in building, prefabrication of parts of houses; in music, the movietone, the transcription, and the juke box; in the glass container industry, the introduction of automatic machinery—in these and a thousand others, machinery has displaced labor. In the long run, opposition to such changes has usually been futile, although for a while it is sometimes successful. The building crafts have maintained a fairly effective defense against the use of prefabricated parts in building houses; and this is one reason why housing construction is so expensive. However unfortunate the results may be, it is not surprising that organized labor has opposed technological changes, has fought to retain jobs; nor is labor the only class that opposes changes which affect its interest. Retailers oppose the chain stores; railroads oppose truck transportation; the glass bottle manufacturers try to prevent the use of paper containers; businessmen try, often successfully, to build tariff barriers around the states in order to exploit consumers through higher prices. Human nature seems to be much the same in all classes.

Conclusions as to make-work rules. A few conclusions as to make-work rules may be worth drawing. In the first place, the general public is probably inclined to exaggerate the extent to which labor unions resort to such rules. Many unions have make-work rules, but they are most common in the building trades unions, where the public is made keenly aware of the expense and trouble they cause, and in the railway trainmen's unions. In the second place, some restriction on the speed of work and the size of the working crew is often needed, although many unions go far beyond the realm of reason in this respect. In the third place, make-work rules probably have a tendency to reduce union wages, because there is a limit to the amount that can be squeezed out of the employer, and whatever he pays for unnecessary labor he cannot pay for essential labor. In the fourth place, unless a union is industry-wide, make-work rules may cause a relative decline in output and employment in the union plants; furthermore, such rules are no remedy for a scarcity of jobs in a declining industry; they merely hasten the decline. Finally, make-work rules provide no remedy for general unemployment. They may provide more jobs in a given industry, at least for a while, but to the extent that they raise costs in it they tend to reduce employment in other industries. The make-work policies of the railway trainmen may increase employment in this branch of the railway service, although it is not certain that they do this in the long run; but by raising costs they tend to reduce the amount of railway service offered, and perhaps to force the partial abandonment of some of the weakest roads, so reducing employment in all the industries that furnish railroad supplies; while on the other hand, by making higher railway rates necessary, they tend to reduce profits and employment in all the industries that use the railways, which means practically the entire economy. This, at any rate is the short-run tendency. In the long run all labor will tend to be employed but, except for the railway trainmen, at lower wages than would otherwise be paid.[4]

Violence in labor struggles

Sometimes, unfortunately, labor unions go much further than merely maintaining make-work rules. Gangster and hoodlum tactics are employed by a few unions, perhaps as a regular practice. In some cities, union moving-picture operators have made a practice of bombing theaters where non-union men are employed, and contractors who hire non-union labor sometimes find their buildings wrecked by bombs. Some years ago Harry Orchard, of the Western Federation of Miners, accused of a bomb murder, turned state's evidence and confessed to bombings and murders committed by him and a confederate over a period of six years that resulted in at least twenty-one deaths; but the state was not able to convict any of the union officers. In the famous McNamara case, the McNamara brothers, members of the International Structural Iron Workers, confessed to bombing the Los Angeles Times building in which ten people were killed; and another member of that union confessed to 102 bombings of bridges and other structures built by the National Erectors Association with which the union was carrying on a bitter struggle. Thirty-eight union officers were convicted and sent to prison. At "Bloody Herrin," Illinois, a mob of strikers and sympathizers killed nineteen unarmed non-union or rival union men, yet none of the murderers were convicted. Picketing, particularly when carried on by large groups of strikers, frequently leads to fights which may result in serious injuries, for in their hatred of the "scabs" who would take their jobs the picketers sometimes manhandle them.

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[4] *Ibid.*, pp. 197–200.

Such violent and dramatic episodes should not be emphasized too much. Although they impress the public mind, they do not represent most unions fairly; they are usually incidents in labor wars, in which there is more hatred and bitterness than most outsiders can easily understand. It has often been observed that class struggles are the bitterest of all conflicts; and in some of the worst cases of labor violence the employers have been scarcely less guilty than the unions. In fact, employer-promoted violence, although less noticed by the public, is perhaps more common than labor-promoted violence. In labor wars, employers often hire thugs and strikebreakers to beat up pickets, and the police are usually willing to club strikers, with or without provocation. It is often difficult to tell who starts the violence, who is to be blamed, but employers must usually bear a considerable share of the responsibility, unless it be conceded that labor is wholly unjustified in trying to organize.

Jurisdictional disputes

Jurisdictional quarrels often put employers to heavy and unnecessary expense. Thus, during the construction of a certain large office building, the bricklayers charged that the structural steel framework had not been erected by the proper craft union; and before they would start the brick work, they required the contractor to tear the framework down, lay it on the ground, and then have the proper union put it up again. In the Hutcheson case, the carpenters and machinists had a dispute as to which should install metal machinery; the result was a strike which caused the employer considerable expense and delay. Such disputes have been common enough to cast well-deserved odium on labor unions.[5]

Sit-down strikes

The sit-down strikes sometimes resorted to during the Great Depression stirred up hostility and consternation even among people not generally opposed to labor unions. There were 477 such strikes in 1937, but the number diminished sharply after that year. When strikers sit down in a factory and refuse to budge or to allow other workers to enter, they are not just "nibbling at the foundation of our system of private property"; they are biting a big chunk out of it. They may argue that they have some right in their jobs, and perhaps in the factory in which they work, but the sit-down tactic looks too much like expropriation of the employer to be popular with the general public—"a high-handed proceeding without a shadow of legal right," the Supreme Court called it. Mussolini came to power not long after a wave of sit-down strikes in Italy.

Newspapers and labor unions

Still another reason for the common hostility to labor unions is the fact that newspapers usually present labor news in a manner prejudicial to labor. To some extent this is true merely because employers are able to buy more newspaper space than the labor unions can afford. Employers often place full-page advertisements in the papers, partly to present their own views and partly to secure the good will of the newspaper management; but most newspapers favor the employer anyhow. The small rural papers represent the views of the little Wanamakers of the community; and the big newspapers are themselves big business, employers of great numbers of workmen and tied up intimately with the country's dominant capitalist interests. Their editorials are usually favorable to employers, and their reporting of labor news is often prejudiced and unfair to labor, or sometimes even grossly inaccurate and misleading. This attitude was never more clearly shown than in the reporting of the great steel strike of 1919. Wages were fairly high in the steel mills, but labor conditions in other respects were intolerable; the twelve-hour day and the seven-day week were still the rule, and the strike was justified; but most of the papers made it appear that wages were very high and that the laborers would have been one big happy family if the radical agitators could have been kept out of the mill towns. Seeing such reports day after day naturally made many people believe them.

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[5] See American Economic Review, *Papers and Proceedings*, March, 1942, pp. 432–448.

Employers' opposition to labor unions

The greatest obstacle to labor organization is the hostility of employers. In some European countries this hostility is no longer common, for in such countries as England and Sweden most employers have come to see that unions are necessary for the protection of labor; and even in America there are a few employers who see that labor organization is at any rate inevitable, and a very few who have worked out plans to cooperate with unions in preference to dealing with unorganized labor. Generally, however, employers in this country are stubbornly opposed to unionization. They regard their plants as their own, to manage and operate as they please; and they view any interference from unions with deep resentment, which, as we have seen, is to some extent justified. Although most of them are themselves organized into associations for the promotion of their mutual interests, in price fixing as well as in fighting labor, they are opposed to any similar organization among laborers and they fight it by fair means and foul.

Weapons used by employers

Employers have fought labor unions in many different ways. They have used black lists, yellow-dog contracts, injunctions, labor spies, strikebreakers, terrorism, citizens' committees, and company unions.

The black list. The black list, a list of workmen suspected of union activities, has been used frequently. A laborer discharged by an employer for suspected or actual union activity is put on the black list, and in some way this information is made available to every member of the employer's association so that no other company will hire the man. Such a laborer may find it necessary to change his line of work or move to a different part of the country. Although the black list has been prohibited in a number of states, it is still used because there is no practical way of proving its existence. Its use in labor disputes, while harsh and deadly in its effect, does not seem very reprehensible to most people, for something like it is often employed by school boards, college presidents, and trustees when hiring teachers. The records of candidates for teaching positions are always investigated, and those suspected of radicalism are usually not hired. Some professors, indeed, have found themselves on something resembling a black list merely because they were too sympathetic toward labor unions.

The yellow-dog contract. The yellow-dog contract, whereby the worker agrees not to join a labor union while employed, was widely used after the First World War; but aside from the possible humiliation of being obliged to sign such a contract, it did not limit his rights appreciably. With or without the contract, he would be discharged if he joined a union. Where the courts upheld such agreements and enjoined labor unions from trying to organize workers who had signed them, they did strengthen the employer's power; but many states have forbidden yellow-dog contracts and injunctions based on them, and under the National Labor Relations Act they are practically outlawed.

The injunction. The injunction against various activities of labor unions has often been used by employers since about the time of the Pullman strike in 1894. In that strike the federal District Court issued a sweeping injunction prohibiting Eugene Debs, president of the American Railway Union, and all other persons from interfering with the business of the railroads entering Chicago, and from trying in any way to induce their employees to leave their jobs. The injunction was one of the important means of defeating the unions in that historic struggle. In ordinary legal procedure, a man is presumed to be able to protect his rights by suing for *damages* if they are invaded; but the injunction is an extraordinary legal remedy, a court order forbidding the enjoined person or persons to do certain specified wrongful acts, on the ground that damages secured after these acts have been committed would not for some reason be adequate compensation. As applied to labor disputes, the injunction has been used to prevent strikes or picketing, to limit picketing in some way, or to prevent various other union activities, on the theory that if the threatened wrongful acts were committed the employer might not be able to collect full damages for the injuries suffered thereby. The employer usually prefers an injunction to other legal remedies because it immediately throws a certain stigma on the union cause, perhaps delays the strike, and because it keeps the dispute out of the hands of a jury. If the injunction is violated, or is asserted to be violated, the case is tried by the judge alone, without a jury. The Constitution guarantees everyone the right to trial by jury, and labor unions regard the injunction as a violation of this constitutional right. It is seldom or never used in Europe, and the federal government and some of the states have recently restricted its use in this country; yet employers still resort to it occasionally.

Labor spies. Employers have spent millions in the employment of labor spies, men who take jobs as ordinary workmen, spy upon the other employees to find out which are union members or agitators, and report this information at once to the detective agency by which they are hired. If possible, the spy joins the union and perhaps become an officer; sometimes he even plays the part of an agitator and tries to foment dissension and discord in the union. When the men reported as belonging to a union are discharged, the other members, uncertain as to who has betrayed them, suspect one another, cease holding meetings, and the union breaks up. "Very dirty business" the La Follette Civil Liberties Committee called this; but many employers have resorted to it to some extent, possibly on the theory that anything is fair in war, and that labor conflicts are one form of war. The use of labor spies is now forbidden by the National Labor Relations Act.

Strikebreakers. In case of a strike the employer often hires professional strikebreakers. These are not mere scabs—men who are willing to take the strikers' jobs because they want work; they are usually thugs, gangsters, hoodlums, and sometimes criminals, whose function is to promote violence and spread terror. Not infrequently these men are backed by the local police force or by citizens' committees or vigilantes which are hired by the employer to preserve "law and order" by beating up the union members and the "agitators" and "communists." In the campaign waged by some of the big California fruit ranch corporations and industrial concerns against labor organizers, such citizens committees did the dirty work, frequently manhandling their victims savagely and in some cases killing them outright. In the Bisbee, Arizona, deportation case during the First World War, a mob seized 1186 strikers, took them out into the desert by train, and left them there without food. The strikers were rescued later, near death from starvation, by the United States Army. No one was punished.[6]

There is seldom any redress for the victims of such violence, for the local police officers are usually in cahoots with the strikebreakers. Some Pennsylvania steel and coal towns are completely in the power of the employers, for the latter's private armies of guards assume control not only of the plants but of the towns themselves. In some of the coal towns in West Virginia and Kentucky, the companies own the entire town—mines, city blocks, streets, churches and schools, and the roads leading to the town. Labor organization in such medieval principalities has been dangerous business. If strikebreakers and the local police and citizens' committees are not able to maintain order, the state militia is sometimes called in. The militia is often sympathetic toward the employer, although it is usually more impartial than the police.

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[6] E. E. Witte, *The Government in Labor Disputes*, chap. 8.

Terrorism. A good example of employer terrorism may be found in the report of the La Follette Committee on Violations of Free Speech and Rights of Labor. Tom Girdler, manager of the Jones & Laughlin steel mills at Aliquippa, Pennsylvania, held almost feudal control over the town and fought labor unions with about every weapon known in labor warfare. He maintained an elaborate system of espionage which not only permeated the plants but extended into the schools, churches, lodges, and homes. Any careless remark by a laborer was likely to be reported, the man's home might be raided, and if any evidence was found indicating that he was a "troublemaker" or "agitator" he was likely not only to lose his job but to be driven out of town. The company owned most of the houses and sold some of them on long-term payments; and for workers who were paying on their homes such an outcome was a catastrophe. Girdler's Gestapo, supported by the town police, sometimes met incoming trains to prevent labor organizers from coming in, and anyone who looked like one was likely to be arrested, beaten, and put on the next train leaving town. Girdler and his company operated a tight political machine, chose the men for city and county offices, marked the ballots that were handed out to the workers, so that every man's vote was known. Not a beautiful picture. As Mary Heaton Vorse has said: "It is a horrible thing to live in a community where every act is spied upon. It is a horrible thing to live where an incautious word, or the expression of an opinion, may cost you your job. And it is a wonderful thing to see a town freed from this espionage."[7]

Such labor policies as this have been common in the steel mills and in some of the southern cotton mills. The United States Steel Corporation set the style years ago. In one Pennsylvania steel town the sheriff, after breaking up a workers' meeting and driving some agitators out of town, declared that Jesus Christ himself wouldn't be allowed to make any speeches there.

Company unions. Since the First World War, many employers have fought off the organization of labor by forming their own company unions. The number of workers included in these unions increased steadily until 1928, when more than 1.5 million members were reported. These company unions were usually formed at the instigation of the employer and were controlled by him, although presented to the world as representing labor. They did some useful things, such as adjusting grievances and complaints with respect to health, safety, wages, hours, rules and regulations, the sharing or rotation of work, discharge of employees, and other similar problems; but they could not function as genuine collective bargaining agencies because their organization seldom extended beyond a single plant, they had no funds, and few of them could provide the leadership and experience necessary for aggressive union action such as a strike. The National Labor Relations Board does not recognize company unions as genuine bargaining agencies, and forbids employers to maintain them.[8]

Labor unions and the government

The fight against employers would be tough enough for the unions, but the job has been even more difficult because, before the advent of the New Deal, employers usually had the support of various arms of the government—the courts, the police, and the militia. The courts usually see eye to eye with employers for two reasons. In the first place, basing their opinions on precedent in accordance with the rule of common law, they tend to look backward to the time when the philosophy of rugged individualism was more appropriate than it is in our present economy of giant industries and armies of workers. In the second place, courts are composed of lawyers, many of them former corporation lawyers, who in their years as servants of big business became so accustomed to the employer's point of view that they find it difficult or impossible to understand any other. This is not true, however, of the United States Supreme Court today, for several conservative judges died during Franklin Roosevelt's administration, and their places were taken by liberals. The police can usually be counted on to support the employer's position. Sometimes the police deliberately try to incite the workers to violence, and they frequently behave as if they were the employer's private guards. The state militia too is usually though not always sympathetic with the employer. The ideals of military men—order, discipline, obedience—fit well with the ideals of businessmen. An army organization is about what employers would like in their businesses; and it is not surprising that the militia should be inclined to support the employer when it is called in.

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[7] Mary Heaton Vorse, *Labor's New Millions*, pp. 34, 35.

[8] Emanuel Stein, Jerome Davis, and others, *Labor Problems in America*, chap. 31.

The manner in which employers, courts, and police work together may be seen in the records of some of the historic labor battles. In the Haymarket bombing in Chicago in 1886, for instance, a mass meeting was called in Haymarket Square to protest against police brutality in the McCormick Harvester Company strike. Although the meeting was peaceful, the police appeared suddenly and demanded that the crowd disperse. Someone threw a bomb into the police ranks, killing several policemen, whereupon the police began firing into the crowd and injured about a hundred people. Many arrests followed; and eventually four men were hanged, one committed suicide to escape hanging, and three were sentenced to imprisonment, two of them for life. The men were labor radicals, it is true; but careful study has proved that the judge who presided at the trial was grossly biased, as was also the jury, and that perjured evidence was offered—in short, the defendants did not have a fair trial. Somewhat similar was the case of Tom Mooney,, the radical labor leader who was accused of planting a bomb in the way of a preparedness parade in San Francisco in 1916. There was much perjured testimony at the trial, a conspiracy between the prosecution and certain police officers, and an unfair trial as the presiding judge conceded later; yet Mooney was convicted and sentenced to be hanged. The supreme courts of California and the United States refused to intervene, but at President Wilson's request the governor commuted Mooney's sentence to life imprisonment. Twenty-two years later he was pardoned by Governor Olson, and died within a few years.

Internal difficulties of unions

Even within their own unions, the members face serious difficulties in organization and in trying to keep their unions working effectively. They must build an organization that is practically workable, one that vests enough autonomy in the local to give it some feeling of self-determination and at the same time centers enough power in the central offices so that the power of the entire union can be thrown into a contest if necessary. A union must have honest, unselfish, competent, and courageous yet judicious leadership, a combination not easy to find. The men who come to the front when the union is being formed are usually men of courage and loyalty, and in some cases tactical shrewdness; but when they have been long in office many of them become soft and conservative, and more interested in holding their jobs than in vigorously advancing the interests of labor. If the leader is exceptionally able, he may be offered a higher-paying job in business or in the government; if he is not particularly able, it may nevertheless be possible for him to hold his job in spite of almost any amount of opposition. High positions in labor pay good salaries—Green receives $15,000 a year, and John L. Lewis $25,000. Such salaries enable these men to associate with the "better people."[9] If the leader is not strictly honest—and this has been true of a few of them—he has many chances to make a little extra money in his negotiations with employers.

In their internal administration, many unions follow the pattern of business corporations, and of Fascist governments, in some respects. Many of them are not democracies but, like corporations, are ruled by self-perpetuating oligarchies or personal dictators. Like corporation stockholders, the members generally know little about the union's business and seldom attend the meetings, trusting the officers to handle things well for them. The officers run the union according to their own lights, sometimes without making adequate reports on policies or finances. The dues and fines of the New York local of the American Federation of Musicians amounted to $300,000 in one year, but no financial report was made for a considerable period. Some national unions allow the locals almost no power, and even appoint the officers of the locals. The Federation of Musicians is one of the most autocratic of all unions, for the members are little concerned with its business, and Petrillo, its president, whose salary is reported to be $46,000, frankly claims to be the absolute dictator.[10]

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[9] The high salaries of some American labor leaders are in striking contrast with the modest salaries paid union officials in Australia, which before the war averaged about $1200 a year; only a few were above $2000.

The New Deal and labor unions

It has sometimes been charged that the New Deal was in some respects merely a "new shuffle"; but for labor it was indeed a "new deal." Even before Franklin D. Roosevelt took office, the public had shown some sympathy toward the grave hardships of unemployed labor, and the Norris-La Guardia Act of 1932 had placed strict limitations on the issuance of labor injunctions by federal courts and had outlawed yellow-dog contracts. The National Industrial Recovery Act of 1933 included a provision guaranteeing employees the right to organize without "interference, restraint or coercion of employers"; and when it was declared unconstitutional, its guarantees were expanded by the National Labor Relations Act of 1935, which also prohibited a number of what were called "unfair practices" used by employers in dealing with labor, and set up the National Labor Relations Board to administer the act.

Here was something new in American labor history, a government agency helping laborers to organize! The National Labor Relations Board not only helps labor to organize but tries to shield it from various "unfair labor practices" on the part of the employer. Under the provisions of the law it is unfair practice for an employer:

1. To interfere with, restrain, or coerce employees in exercising their rights of self-organization and collective bargaining.
2. To encourage or discourage union membership by discriminating in regard to hire or tenure of employment or conditions of work, except such discrimination as may be involved in a closed-shop agreement with a bona fide union.
3. To dominate or interfere with the formation or administration of any labor organization, or to contribute financial or other support to it.
4. To refuse to bargain collectively with the representatives of the employees.
5. To discharge or otherwise discriminate against an employee for filing charges or testifying under the act.

The law indicates a clear and unmistakable intention to *promote collective bargaining,* to put labor on the basis of something approximating equality with employers in bargaining. In interpreting and administering the law, the Board is upsetting many cherished powers and privileges of employers. For instance, it has held that anti-union statements by an employer are a violation of the act, "especially when coupled with a threat to close or move the plant if the employees join a certain union or select certain representatives." In one case, that of a company which allegedly moved its plant to avoid the union, the Board ordered it to pay moving costs for the union members who wished to move to the new location.[11] Clearly the rights of property are being severely abridged by such decisions, although they seem to be logical interpretations of the law. Some employers have fought the law and the Board with every available weapon; but only a small proportion of the complaints filed with the Board have ever reached the courts, and most of the Board's decisions that have been appealed to the Supreme Court have been sustained. Some employers—Henry Ford, and Tom Girdler of "Little Steel," among them—refused to abide by the Board's rulings, and since the Board is obliged to go into a federal court to secure an order for enforcement, the defiance was overlooked for some time.

The National Labor Relations Act was not enacted in the interests of labor only, but in the hope that it would result in mutual benefits to employers, workers, and the general public; and there is no doubt that in some cases it has been of distinct advantage to both the employer and the public. Once written collective agreements have been signed by employer and employees, the employer knows what he can expect in the way of employee cooperation, for these agreements commonly stipulate that there shall be no strikes or lockouts and that all disputes shall be settled by peaceful means. They also cover a great many other troublesome problems, such as hours, wage scales, overtime payments, seniority regulations, and vacations. According to Millis, "employers with long experience under contracts rarely desire to return to the uncertainties of a shop kept in a state of worker restlessness because of the absence of a written document embodying the pledge of mutual responsibility."[12] While the public probably pays higher prices for some goods because of the spread of unions under the act, it gains from the reduction in the number of strikes and from the greater continuity of industrial operations. For example, after the outbreak of World War II there were very few strikes of importance, a very significant achievement in time of war.

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[10] See John P. Troxell's article in American Economic Review, *Papers and Proceedings,* March, 1942, pp. 460 ff.

[11] Richard A. Lester, *Economics of Labor,* pp. 720–721.

General appraisal of labor unions

What balance sheet of gain and loss, of credit and debit, shall we strike on the question of labor organization? Many labor enthusiasts would have us believe that labor unions are almost wholly good and that our society would be very happy indeed if all labor were organized, whereas other people view the progress of unionization with deep fear and distrust. In appraising this movement we can scarcely hope to be entirely fair, for our attitudes will inevitably be colored by our emotions, experiences, sympathies, social attitudes, and perhaps our economic circumstances. And, as often in economics, we shall find that there are no simple answers, that labor unions are good in certain ways and with respect to certain ends and ideals, and bad in other ways and with respect to other ends and ideals. Furthermore, most generalizations regarding labor unions are likely to involve some error when applied to particular unions, for in their ethical ideals and practices, their economic philosophy, their internal organization, and the character of their leadership, labor unions differ widely. In their ethical ideals and practices, some unions are almost wholly admirable, while others can be classed only with the lowest types of rackets; in their economic philosophy, some of the A.F. of L. unions are almost as conservative as some businessmen's organizations, whereas a few at the other end of the scale are dominated by communists; in their internal organization some leave fairly wide powers to the locals, while others are more or less completely dominated by the central offices; in character of leadership, they vary from fairly liberal democracy to the iron-bound autocracy of John L. Lewis's United Mine Workers and Petrillo's musicians' union. In spite of the difficulties in making a broad appraisal of unions, we may venture a few generalizations, beginning with those unfavorable to unions.

It is clear that labor unions and their tactics do not fit the simple theory of collective bargaining. If the laborers simply combined in order to bring their bargaining strength up to that of the employer, and if when dissatisfied they simply quit and sought work elsewhere, making it necessary for the employer to build up a new labor force, that would be simple collective bargaining, and labor troubles would not be very serious; but such a procedure is of course impossible. Laborers cannot move about or get jobs elsewhere so easily. When they strike they want to prevent the employer from hiring other labor. Sometimes the employer could hire another force for as little as he is paying the strikers, or in times of depression perhaps for less; but those on strike refuse to work on the conditions he offers and they try hard to prevent others from taking their jobs. Their hatred of scabs is as deep and as sincere as Martin Luther's hatred of the devil, and they often throw worse things than ink bottles at them.

There is some reason to believe that, as Marshall hinted, the effect of labor organization may be to push the few up and the many down. Only a small proportion of the total labor population of the United States has ever been organized—9 per cent in 1930 and 25 per cent in 1944—and therefore only a small proportion of the laborers can gain any direct benefit from organization; and it is likely that the burden of the higher wages enjoyed by union members falls largely on the unorganized workers who are the most important consumers of many of the products of industry.

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[12] H. A. Millis, "Six Years of the National Labor Relations Act," *Labor Information Bulletin*, August, 1941.

On the other side of the picture, it has often been pointed out that the individual laborer who is one of a large number in a huge plant cannot bargain with his employer on equal terms. The employer has every advantage—he usually has ample financial resources, his personnel staff is highly skilled, and if he does not make a wage contract with one employee he suffers no great loss; it does not make much difference, for instance, whether he has 5000 workmen or 4999. The individual worker, on the other hand, seldom has much in the way of reserve funds and needs a job immediately; he is not a skilled bargainer and he often knows little about opportunities for employment; and if he does not get a job he is likely to suffer grave hardship. As a matter of fact, there is usually nothing that can be called bargaining between the employer and the employee; the former offers what he thinks he must and the latter either accepts, or at great sacrifice continues his quest for work elsewhere. The answer to this inequality of bargaining power between employer and employee is *collective bargaining*, with labor organized in a union that will act as a unit in disputes with the employer. The employer may well be indifferent as to whether he hires or loses *one* man, but he cannot be indifferent as to the loss of *all* his men.

Employers' associations

The case for labor unions is really stronger than this argument indicates, for some employers are themselves organized in powerful associations. At one time there were some 250 such associations—national, state, and local—coordinated under the National Industrial Council, an organization which was said to represent the interests of between 30,000 and 35,000 manufacturers in labor relations. The National Industrial Council has been the labor-fighting subsidiary of the National Association of Manufacturers, which is the national agency coordinating the power of some 30 or 40 billion dollars in corporate wealth. Formerly associated with the NAM was also the aggressive National Metal Trades Association, which furnished its members with labor spies, guards, and strikebreakers whenever a strike was called in any of the member plants. This association assumed full control in the fight against strikers, and none of its members was allowed to settle a strike on terms other than those that it laid down, or to enter into any closed-shop agreement with a labor union.[13] Such an organization as this could not function today, under the National Labor Relations Act, but the NAM is working hard to secure the repeal of that law. Certainly labor unions do prevent the highly organized and integrated industries from becoming intolerable autocracies. If there were no unions, a handful of corporation executives would dominate industry so completely that laborers could live only by their grace. As Slichter says, collective bargaining is not only a method of fixing wages but a "method of introducing civil rights into industry, that is, of requiring that management be conducted by rule rather than by arbitrary decision."[14] Where labor is not organized, the individual laborer not only is at a disadvantage in bargaining with the employer, but he holds his job entirely at the will of the manager or foreman, and at the whim of either he may find himself on the street looking for another job. Within limits set by state or federal laws, he must work under whatever conditions the employer provides, sometimes under conditions injurious to health or dangerous to life and limb; and he may be dismissed for any reason whatever or for no reason at all. By organizing, labor is able to maintain a position of greater security and self-respect.

Labor unions provide some training and experince in cooperative action, training which may be valuable in solving problems in democratic government; some provide social, educational, and recreational opportunities, and insurance benefits; they give the members political influence which they would not have without organization. When the C.I.O. contributed nearly half a million to the Democratic campaign expenses in 1936, it was speaking a language that politicians understand.

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[13] National Resources Committee, *The Structure of the American Economy*, Part I, p. 165.

[14] Sumner H. Slichter, *Union Policies and Industrial Management*, p. 1.

Employer-Employee cooperation

From some of this discussion it might appear that employers and organized labor are always at war; but in a few industries employers work cooperatively with their unions, and under the National Labor Relations Act this is required of employers in unionized industries. Here is one of the moderately cheering developments in the field of labor relations. When employers and their employees view each other with suspicion and hostility, each trying to overreach the other, to give as little and get as much as possible, each generally uninterested in the other's problems and difficulties, there can be little sound health in industry, and the industrial field will be an armed camp likely to become a battleground at any time; but where employers and employees are able to take a cooperative and sympathetic attitude toward the common problem of keeping production up and costs down, there may be a basis for industrial peace. To some extent the interests of the two groups are the same. To the extent that competition prevails, both want production and employment maintained at a high level, and both must therefore be interested in keeping costs down to a point which will enable the employer to do this and in some cases even increase production.

This cooperation demands an understanding attitude on the part of both employers and employees. The employer must recognize that his workers are not merely slaves or chattels, insensate means of making profits, but human beings, with the wants and aspirations of human beings. He must be able to meet his employees' representatives as equals and be fair, honest, and straightforward with them, if he is to gain the confidence essential to cooperation. The workers, on the other hand, must have some understanding of the problems that the employer faces, must not regard him as a money well to be pumped as hard as possible, must help him in the joint task of keeping costs down to a level which will enable the business to earn wages for them and a reasonable return for him. They must be reasonable in their demands, must help to maintain efficiency, and must live up to the agreements they make.

Most employers and workers, unfortunately, do not meet these specifications very well, and union-management cooperation has achieved only limited success. In a number of cases it has been tried for a while and then dropped. It is apparently most likely to succeed in firms that are not making high profits, that are so near the no-profit level that both employer and employees feel some concern over the future of business operations and jobs. This type of cooperation may never become very common, but there is some reason to believe that it may spread and help measurably in maintaining efficiency and peace in industry.[15]

The government and labor disputes

Strikes and labor wars are expensive to workers, employers, and the general public; and the government has tried in various ways to help preserve industrial peace—through mediation, arbitration, and, in a few cases, through prohibition of strikes. In the process of *mediation*, an impartial third party, known as the mediator or impartial chairman, is called in; he confers with the employer and labor representatives in a friendly, informal way, and tries tactfully to get them together. If he is unable to do this, he is not expected to render any decision in the dispute. In the process of *arbitration*, an arbitrator or board or arbitrators is chosen, and after hearing the two sides it renders a decision which the disputants have agreed to accept; if either party is not satisfied with the decision, the dispute may come up for further action later. Both mediation and arbitration have achieved some success in promoting industrial peace.

The public interest in industrial peace, particularly in such essential and strategic industries as transportation, mining, and steel manufacturing, is so great that some people think strikes should be forbidden. Why, they sometimes ask, can we not set up an impartial board to settle disputes, instead of allowing the employer and his workmen to fight it out, with all the cost this involves for both of them and for the public as well? After all, a strike proves only who is stronger, not who is right. The argument, although superficially appealing, does not face all the difficulties of the problem. The strike is labor's most important weapon; and if labor is to be deprived of this weapon, it will have to be convinced that a really impartial board will decide the dispute. Until recently, labor in this country and in most of the individual states has been hostile to compulsory arbitration, because most workers have believed that government agencies were likely to be unfriendly to them. Furthermore, compulsory arbitration smacks a little of "involuntary servitude," since the government in denying the right to strike is practically compelling the workers to remain at their jobs. This may be justified in essential industries, and in wartime it is unquestionably necessary; but in non-essential industries and in peacetime such a policy may not be wise.

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[15] See *ibid.* for an analysis of this problem.

Nevertheless, a variety of measures have been adopted both here and in other countries. Among them are: (1) *compulsory arbitration*, which prohibits strikes and requires the parties to submit their disputes to a government arbitration agency; (2) *compulsory investigation*, which requires only that the strike shall be postponed until the government arbitration agency has investigated the issues in the dispute; (3) *compulsory acceptance*, which requires that, although arbitration may be voluntary, the decision of the arbiter must be accepted; and (4) *compulsory delay*, which forbids the union to strike for a certain period after the arbiter has handed down his decision. The last three are of course less drastic than the first, and there has been no serious objection to them, but compulsory arbitration has been the subject of heated debate. Canada has tried compulsory investigation, in public utilities and mines, with some success, even the workers eventually coming to favor it; and Colorado, Minnesota, and Michigan have passed similar laws.

Compulsory arbitration

New Zealand is the pioneer in the field of compulsory arbitration, by virtue of a law passed in 1894. This law set up a court of arbitration composed of three members representing employers, labor, and the public, but workers submit disputes to the court only if they wish to as members of unions which agree to abide by its decisions. Unions that wish to come under the court's jurisdiction are given certain privileges, as for instance the closed shop, and for this reason the law has greatly encouraged labor unionization. Although it has not altogether prevented strikes, it is generally credited with a great reduction in their number.

Only Kansas, of the various American states, has tried compulsory arbitration, under the Kansas Industrial Disputes Act of 1919. The law, passed during a fit of public exasperation over a strike in the coal mines, was frankly anti-labor in motive and spirit, and hence has been consistently opposed by the unions. It did not prevent strikes, but it was the means of sending a few labor leaders to prison and stirring up ill will among labor in general. It became something of a political football and was in process of being deflated to comparative innocuousness when the Supreme Court held it unconstitutional on the ground that some of the industries covered were not so "affected with public interest" as to be subject to such drastic regulation. The experience of Kansas does not prove that compulsory arbitration is impossible, but it does suggest that it is not likely to be successful if it is conceived mainly as a club with which to crack down on labor.[10]

The outlook for organized labor

On the whole, the outlook for peace on the labor front is not bright. The high wages paid during World War II roused great public hostility to labor unions, and Senators and congressmen from states in which the labor vote is small find strong support in advocating the abolition or mutilation of the New Deal laws favorable to labor and the hamstringing of the National Labor Relations Board. This support comes not only from farmers and small businessmen but from powerful organizations like the National Association of Manufacturers and the Chamber of Commerce of the United States. A strong and well-organized campaign is being waged to reduce labor's growing power; and with the growth of reactionary sentiment which usually characterizes war and postwar periods there is a possibility that this campaign will achieve some success, perhaps even to the extent of crushing many of the weaker labor unions. Labor's reaction to such a situation is difficult to predict, but certainly there will be strong resentment, and possibly more violence than we have ever seen before. Labor has tasted power and therefore will never again be resigned to the impotence of former times.

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[10] See Domenico Gagliardo, *The Kansas Industrial Court.*

Labor may eventually come to dominate our government as a "labor" government, somewhat as business interests have generally dominated it in the past, subject to some limitations in Roosevelt's administration. Such a possibility is enough to give businessmen and conservatives a bad case of the jitters; but this outcome might not be a serious catastrophe, and it might mean better government than we have usually had in the past. Several of the most enlightened countries in the world have labor governments—New Zealand, Australia, Sweden, and Great Britain. Their policies seem radical to most Americans, for most of us are very conservative in our economic and political attitudes; but those countries have staged a better economic recovery from the Great Depression than we have.

Labor has a tremendous stake in the future trend of government in the United States, as in other capitalist countries. If the government remains democratic, labor will probably fare better than in the past; if the government turns to Fascism, labor may be reduced to a position closely resembling slavery, as it was in Italy and Germany. Indeed Fascism, in one of its aspects, is a system of government set up by businessmen and other conservative interests specifically to keep labor down; it is one of the possible answers to the growing power of labor. When labor becomes so strong that it can dominate government policies, it will demand many changes making for better conditions, social insurance, and the like, and perhaps eventually even socialism; and the ruling business classes must either agree to these demands or try to clamp down a Fascist dictatorship on the people and take away their votes. The countries that have given labor the reins of government have clung to their democratic principles; Germany and Italy turned to Fascism. It is possible that the United States will some day have to choose between these two alternatives; and there is no certainty that we will choose to retain democracy.

If we retain a democratic system of government, labor is likely in the long run to gain in power as its ranks increase in number, and will probably be able to secure better working conditions, greater security, and more voice in economic and political affairs generally. The government will probably intervene more in the determination of wages, hours, and working conditions, and in labor disputes. It will probably assume increasing control over industries, and some of them may be socialized, with consequent gains to the labor in those industries, for the government is a generous employer. The far-off end toward which labor is driving may be nothing less than socialism, for labor is on the march, but its goal is not clearly outlined. Although most American unions are not radical, it is clear that, as Slichter says, they "are nibbling at the very foundations of the economic order. For they contest the control of industry by property owners and assert that government in industry should rest upon the consent of the governed. But the very essence of private property is the right to make decisions, and when unions limit that right and divide it between the property owners and the workers, they are making a fundamental change in private property itself. It is a delusion to pretend that this is not revolutionary. But most revolutions are accomplished by men who know not what they do."[17]

Even if our economy remains democratic, the government may assume increasing control over labor unions, may require them to make reports covering their receipts and expenditures and other details of their business. The unions object to this, of course; but if they are to have the support and encouragement of the government, they might well be expected to make public the nature of their business. In some cases this would benefit their members because it would prevent the exploitation by officers which, if not as common as many people believe, has been altogether too common in the past.

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[17] Sumner H. Slichter, *Modern Economic Society*, p. 204. By permission of Henry Holt & Company, Inc., publishers.

QUESTIONS

1. Trace the history of labor unions in the United States.
2. Labor unions usually tend to break up in depression times. Why was John L. Lewis able to organize so many in the depth of the depression?
3. Can the closed shop be justified? Does it not constitute interference with the freedom of labor? Explain.
4. Which of the following seem justified to you: the strike, the checkoff, picketing, the "job right," the boycott, political contributions by labor organizations?
5. What are some of the obstacles to labor organization?
6. Enumerate and explain some of the unfair practices engaged in by labor unions.
7. Why do farmers usually take a hostile attitude toward labor unions? Are farmers not laborers?
8. What are some of the weapons used by employers in fighting unions? Are employers justified in using injunctions?
9. Why does the A.F. of L. often line up with employers against the C.I.O.?
10. What is the general intent of the National Labor Relations Act?
11. Why is it difficult to make a fair appraisal of labor unions?
12. On what basis would you justify the principle of collective bargaining?
13. What conditions are essential to successful employer-employee cooperation?
14. Name some of the methods used by governments to prevent strikes.
15. In recent years our government has come more under the influence of labor than it used to be. Can you view this with indifference? How could the labor governments in Sweden, New Zealand, Australia and Great Britain develop high standards of efficiency and integrity?
16. "Labor unions and their tactics do not generally fit the simple theory of collective bargaining." Explain why.
17. Argue that labor officials should publish financial statements as corporations do.
18. Do make-work rules increase the amount of employment? Discuss fully.

Chapter 29.

Interest

We have now completed our analysis of wages, the first of the four shares into which the national income is divided, and of some of the important labor problems; and we turn to the second of these distributive shares, interest, which we have defined as the payment for the use of capital, or man-made instruments of production.

The student doubtless already knows something about interest. He knows that if he goes to the ogre who stands behind the grille in the bank and asks for a loan, the ogre, or perhaps merely a flint-hearted banker, always demands interest on the loan, demands that more be repaid than was borrowed. The student may have seen so many transactions of this sort that he thinks of the payment of interest as being as simple and natural as it is for people to demand food when they are hungry. Nevertheless, the nature of interest and the forces that determine the rate of interest present rather difficult problems; nor are economists altogether agreed in their analysis of these problems.

Gross interest and pure interest

We may begin our discussion by distinguishing between *gross* interest and *pure* interest. The amount actually paid on a loan is gross interest, and to get pure interest we must make several deductions. In the first place, some expense and trouble are ordinarily involved in making a loan. A mortgage loan, for instance, calls for an examination of the abstract to the property, periodic inspection of the property during the term of the loan, some expense and trouble in collecting interest payments, and the expense of foreclosure if the loan is not finally paid. In the second place, any loan nearly always involves some risk, some danger that it may not be repaid fully and promptly or at all, or that it may be paid in money of lower purchasing power than the money which was lent originally. The amount of risk varies greatly in different types of loans, from almost none in a United States bond to extremely heavy in small personal loans to indigent people. In the third place, some loans involve inconvenience to the lender. A perfect loan in this respect is one which can be recalled at any time; but most loans are made for a specified term, and however much the lender may want his money returned earlier, he must wait until the end of the term. Call loans in the stock market, which are supposed to be callable at any time, are an exception to this rule, and, significantly, such loans are usually made at a very low rate of interest. By purchasing high-class bonds which have a ready market, the lender can get his money back at practically any time by selling the bonds; but such bonds likewise yield a low rate of interest and a small expense is involved in buying and selling them. In the fourth place, most loans, whether in the form of direct loans or in the form of bonds, are subject to taxes, and the taxes must be subtracted before we have pure interest.

Variations in gross interest

Pure interest tends to be about the same on all kinds of loans and in all money markets; but gross interest varies widely. The rate on call loans in the New York money market may be as low as 1 per cent or, in crisis times, as high as 100 per cent, varying with the demand for and supply of money. Interest on very safe government, municipal, and corporation bonds may be only 2 or 3 per cent; interest on farm mortgages runs at from 4 to 6 per cent; bank loans to small borrowers run at 6 to 8 per cent; building and loan contracts often call for interest at 8 or 9 per cent or even as high as 12 per cent; the interest charged on installment loans frequently is 20 per cent or more; and chattel loans to the very poor, and pawnshop loans, are sometimes made at 100 per cent or in rare cases as high as 400 per cent. Such variations as these represent differences in the trouble, inconvenience, and especially the risk, that are connected with. the various types of loans.

With some kinds of loans it is difficult to tell what interest rate is actually being paid. In lending to customers, banks sometimes charge what is called a *discount;* that is, they take the interest out at the time the loan is made, instead of waiting until the loan is paid. In such cases the borrower is paying interest on more than he borrows; he is paying interest on the interest taken out, on money which he does not receive. Thus a discount rate of 6 per cent, although it is likely to be called interest, is more than 6 per cent interest, and many borrowers are unable to figure out just what rate it represents. In amortization loans—loans that are to be repaid in monthly, semi-annual, or annual payments over a certain time, in some cases many years—it is impossible for most borrowers to calculate the actual rate of interest. The payments include interest, at a rate which often is not specified, and a certain amount on the principal, also not specified; and the borrowers cannot calculate how much of the payments are interest without using interest tables or resorting to higher mathematics. Not only are borrowers unable to figure the rate, but often the lending agencies do not know what interest rates their contracts call for. Since such contracts obviously offer an opportunity to exploit borrowers, the government should compel all agencies making amortization loans to ascertain and state clearly the exact rate of interest.

Nominal and actual interest

For still another reason borrowers may not know what rate of interest they are paying, and lenders may not know what rate they are receiving. Many people are unable to distinguish between the nominal and the actual rate. As we have seen in an earlier chapter, the value of money declines in periods of rising prices, and rises in periods of falling prices; and the annual decline or rise in the value of money must be subtracted from or added to the nominal rate of interest to find the rate actually paid or received. Between 1896 and 1914, for instance, the price level rose more than 3 per cent a year, which meant that the value, the purchasing power, of money declined at least 3 per cent a year. A depositor in a savings bank that paid a nominal rate of 3 per cent, actually received no interest at all during this period. Between 1929 and 1932, on the other hand, the price level declined about 42 per cent, or about 14 per cent a year; this meant that the value of money rose about 70 per cent, or about 23 per cent a year, and that the owner of a good 4 per cent bond actually earned about 27 per cent interest annually. This has already been explained in the chapter on price levels.

Significance of the interest rate

Of what significance is the interest rate? What difference does it make whether the rate is high or low? In the first place, it of course makes a difference to lenders and borrowers. If the rate is high, lenders will prosper and borrowers will suffer; and if it is low, the reverse will be true. In the second place, and probably more important, the interest rate is a vital element in the cost of production. From this point of view, a low rate is much to be desired, for it usually indicates an abundance of capital and therefore low costs for producers. If the rate declined almost to zero, as Keynes thought possible, the cost of producing our output of goods would be reduced several billion dollars annually, and more goods would be produced.

The rate of interest is important, in the third place, in determining the value of various capital investments, through the process of capitalization. In the stock and real estate markets, stocks and real estate tend to sell at prices representing the capitalization of the earnings at the prevailing rate of interest. For instance, if a stock earns $4 a share and the rate of interest is 4 per cent, the stock should sell for $100. It will earn 4 per cent at that price. But if the rate of interest rises to 8 per cent, the stock will be worth only $50 if its dividend remains $4, for it will yield 8 per cent on only $50. If, on the other hand, the interest rate declines to 2 per cent, the stock should be worth $200, for it will yield 2 per cent at that price. Similarly, a farm which yields $4 rent per acre should be worth $100 per acre as an investment, if the rate of interest is 4 per cent; but if the rate rises to 8 per cent, the farm will be worth only $50 an acre, and if the rate falls to 2 per cent, it will be worth $200 an acre. A rise in the rate of interest reduces the market price of capital investments, and a fall in the rate of interest raises their market price.

Different concepts of interest

There are various concepts of interest. Many people, including a few economists, think of it as a payment for the use of *money;* others define it as a payment for the use of *loanable funds,* which of course are in the form of money or bank deposits; others look upon it as a payment for *savings;* still others define it as a payment for the use of *capital,* that is, productive wealth, man-made instruments of production; and Keynes and his followers hold to the *liquidity-preference* concept, according to which interest is paid not for the sacrifice of saving, but for the sacrifice of lending rather than holding savings in the form of cash. These concepts are not altogether contradictory, but are for the most part different ways of looking at the same thing, as an examination of each will prove.

Interest as a payment for the use of money

Most people who are untrained in economics think of interest as a payment for the use of money. If they borrow, they secure money in the form of cash or bank deposits; and if they lend, they lend money. It seems natural to them to think of the transaction as involving only money, and of the interest as a payment for the use of money; and for short-run dynamic conditions, as in the shifting phases of the business cycle, the problem is largely monetary. Changes in interest rates for such short terms are largely the result of changes in the demand for and supply of money, which here includes bank deposits.

This, however, is only a superficial concept of interest. Fundamentally, in the long run, interest should not be regarded as merely a payment for the use of money. In the long run, monetary conditions have nothing to do with the rate. If our supply of money were doubled, the price level would rise; but after adjustments to the new price level were completed, the rate of interest would be the same as before. Our conclusion need not be hypothetical, for in the Second World War we saw exactly this situation—a rapid increase in money, largely in bank deposits, a considerable rise in the price level, and yet a practically unchanged interest rate. In the First World War too, there was a vast expansion in the amount of money throughout the world, and a dramatic rise in the price level, but an actual *rise* in the rate of interest. If interest were fundamentally a payment for the use of money, the increase in the amount of money should have brought a fall in the rate of interest.

The notion that interest is paid for the use of money was partly responsible for the fact that for many centuries the lending of money at interest was frowned upon. Aristotle declared that money was "barren" and that lending it at interest was an "unnatural" use of it; and his view dominated the thought of the scholastics through most of the Middle Ages. The Mosaic law similarly forbade lending at "usury" (interest), except to strangers; Christ said, "Lend, hoping for nothing again"; and the Brahminic law included various restrictions on loans. During the late medieval period, as industries grew up and as opportunity and need arose for commercial loans, the churchmen gradually relaxed their ban on loans at interest. Although their reasoning involved much finespun theological and philosophical hairsplitting, they gradually came to see that some loans were really loans of productive capital and therefore might properly draw interest.

Interest as a payment for the use of loanable funds

Instead of discussing interest, even in the short run, as a payment for the use of money, many economists treat it as a payment for the use of loanable funds. There is some advantage in doing this. It is only *loanable* funds, not money in general, that are significant in the problem of interest. Changes in the general demand for and supply of money, as we have seen, affect the price level rather than the rate of interest. Although loanable funds may be in the form of money, they much more generally take the form of bank deposits. In the short run, the loanable funds may represent savings, or they may be loans created by the banks, which do not call for any saving by the banks; but, as we shall presently see, in the long run the bank loans represent money and not loanable funds, and therefore we are not concerned with them here.

Interest as a payment for savings

Thus interest as a payment for loanable funds and as a payment for savings is somewhat the same thing, in the long run, but different factors are emphasized. The view that interest is a payment for loanable funds tends to direct attention to the immediate sources of such funds; the view that it is paid for savings calls for an examination of the source of savings, of the various factors that determine the relative amounts saved and spent by the people. Most people prefer present goods to future goods, prefer not to save; and interest is often regarded as a payment for the sacrifice of saving, of foregoing present satisfactions.

Interest as a payment for the use of capital

The concept of interest as a payment for the use of capital represents an effort to get down to something more fundamental than the immediate, superficial money transaction, something of greater long-run significance. Most borrowers of money want it to buy or create capital with; so the demand for money loans, loanable funds, is mostly a demand for capital, although not entirely that, for a small proportion of the funds borrowed is wanted to spend for consumers' goods. We have already seen that consumers' loans are a small part of the total loans. Most lenders will not lend for any purpose but the purchase or creation of capital, because consumers' loans do not increase the productiveness of the borrowers and therefore do not provide the enhanced income needed to repay the loans.

It is not necessary that capital be lent in order to earn interest, for it may do this quite as well if used by its owner. A Neanderthal man who spent two days in making a bone fishhook which during its lifetime saved him only two days' labor received no interest. If the fishhook saved three days' labor, however, he received interest on it. If he could catch three fish a day without the hook and six with it, three fish would represent the *income* from the use of the hook; but to get the *interest* we should have to subtract enough to cover the depreciation on the hook or to replace it when it wore out. Similarly, in the modern world, the farmer's plow or tractor, the housewife's sewing machine, the factory, will increase the owner's output; and if the increase during their productive life is more than enough to pay their cost, that excess is interest. Interest is the income earned by capital—tools, machines, man-made instruments of production. If the owner uses the capital himself, he receives *implicit* interest; if he lends it to someone else, he receives *explicit* interest. Therefore any discussion of interest must include careful consideration of capital.

Interest may thus be regarded as a payment for loanable funds, or as a payment for the use of capital, because loanable funds are used largely to secure the use of capital. It is clear too that a payment for the use of capital is somewhat the same as a payment for the use of savings, because it is through saving that the supply of capital is increased. The capital in existence represents past savings, and present savings represent the current additions to capital.

Keynes' conception of interest: liquidity preference

In recent years a number of economists have turned to a very different conception of interest, the *liquidity-preference* conception outlined by Keynes. Keynes maintains that "the rate of interest cannot be a return to saving or waiting as such. For if a man hoards his savings in cash, he earns no interest, though he saves just as much as before. On the contrary, the mere definition of the rate of interest tells us in so many words that the rate of interest is the reward for parting with liquidity for a specified period."[1] According to Keynes, many savers have a liquidity preference; that is, they prefer to keep savings in the form of liquid cash rather than to invest them and so give up control over them for a definite time as they would in buying a bond; and interest is the reward not for the sacrifice of saving but for the sacrifice involved in giving up this liquidity preference. This conception of interest is not altogether inconsistent with the savings concept, for money must be saved before it can be hoarded. It merely implies that only a part of the money saved will be lent, and that a higher rate of interest is necessary to induce owners to lend it than is needed in the first place to induce them to save it. Nor is it inconsistent with the loanable funds concept. It merely emphasizes the fact that the loanable funds are restricted to the amount that owners are willing to lend, at the interest rate prevailing, rather than hoard in cash or bank deposits.

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[1] J. M. Keynes, *General Theory of Employment, Interest and Money*, p. 167.

In appraising Keynes' concept we must consider his point of view. Many economists deal largely with long-run tendencies, but Keynes' analysis is related to the short-run conditions of the business cycle, and the conception of interest as a payment for the use of money is therefore appropriate. He is concerned with the problem of business depression; and the hoarding that appears during a depression, mainly in the form of bank balances, is the result of liquidity preference, as he calls it. Some short-term government securities, which most nearly approximate liquid cash, as for instance 90-day treasury bills, have recently sold to net practically no interest, and long-term bonds have drawn only 2 per cent. Keynes' assumption that adequate savings can be taken for granted, that there would be considerable savings irrespective of the rate of interest, is largely valid, as we shall see later. His theory of interest is thus significant, and at least partly valid as applied to the problem of cyclical depression. Liquidity preference is a factor limiting the supply of loanable funds, but it is not an adequate explanation of long-run trends in interest rates.

These various conceptions of interest are all needed in a complete theory. Interest is paid for the use of money, immediately, but only for the use of that part which is lent—loanable funds. These loanable funds, most of which are the result of saving, are used largely to secure the use of capital. In analyzing the forces that determine the rate of interest, we shall regard interest as a payment for the use of loanable funds, although we have defined it as a payment for the use of capital. We shall do this in order to bring our analysis as close as possible to the actual world, where interest, as we see it, is paid for the use of loanable funds.

The rate of interest

Demand for loanable funds. Under competitive conditions, the rate of interest is determined, like any other price, by demand and supply, in this case the demand for and supply of loanable funds. The demand for such funds comes from two classes of borrowers: (1) those seeking producers' loans, to be spent in securing capital equipment for use in productive operations, and (2) those seeking loans to spend for consumers' goods. The latter, as we have seen, are responsible for only a small proportion of the total demand for loans.

Hostility to money lending in medieval times was partly due to the fact that most of the loans were advanced to very poor people—consumers' loans. Thomas Wilson inveighed against "that ouglie, detestable and hurtefull synne of usurie . . . a thinge directlye against all lawe, against nature, and against God," and against "the insatiable usurer which gnawes the poor people daily to the very bones."[2] Most people lived on the verge of destitution, and crop failures or any misfortunes were likely to drive them to the money lenders for help. Since their needs were urgent and their bargaining powers small, the money lenders frequently made cruel use of their power, entangling the unfortunate borrowers in meshes from which escape was difficult or impossible. Somewhat the same situation is found today in such poverty-stricken countries as India and China, where interest rates often are 100 per cent or higher. Marshall raises the question whether money lending, under such conditions, does not on the whole diminish rather than increase the total sum of human happiness.[3]

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[2] Thomas Wilson, *A Discourse upon Usury* (1572)

The demand for loanable funds for productive operations is a demand for the means of securing capital, and capital is wanted for the sake of the product which will be added by its use. So the productivity of capital becomes an important factor in the determination of the rate of interest, so important indeed that some economists have made the marginal productivity of capital the fundamental determinant of the rate. In a purely competitive capital market, marginal productivity and the rate of interest would be identical, because borrowers could pay no more for the marginal unit of capital than it would add to the product, and competition would force them to pay that much.

As the supply of capital increases, its marginal productivity tends to decline after a certain point is reached. If there is a small amount of capital in a given community, the marginal productivity is likely to be high; but as more and more capital is added in the form of new hotels, apartments, mercantile and manufacturing plants, paved streets and highways, bridges, public utilities and the like, the marginal productivity is bound to decline. Consequently, since capital is wanted for the product it will add, the demand curve always slopes downward toward the right, but its slope cannot be determined with certainty. Frank Knight suggests that the elasticity of the demand curve in the United States is about unity; that is, the amount of capital would have to be doubled to reduce the interest rate one-half. If this is true, the owners of capital, which here include the entire nation's productive, man-made wealth, apparently would receive about the same total return regardless of their total capital.[4]

The marginal productivity of capital depends not only on the amount of capital but on what can be done with it, on the richness of the natural resources that may be exploited, and on the efficiency of labor and of entrepreneurs. Rich and abundant natural resources and efficient labor and entrepreneurs in a sense constitute the demand for capital; but, on the other hand, they help also in the long run to build up an abundant supply of capital. They probably tend to keep interest rates higher than they would be in a country with poor resources and inefficient labor and entrepreneurs.

The relation of interest to wages. The relation of capital to labor, of interest to wages, is rather difficult to trace clearly. Labor and capital are closely bound together in productive operations, the product is the joint contribution of both, and under competitive conditions each draws from the total joint return in proportion to its marginal productivity or, under monopoly conditions, its marginal revenue productivity. The entrepreneur adds units of labor and capital to the point at which an equal investment in each brings equal returns. From this it might seem to follow that a decline in wages would lead entrepreneurs to demand more labor and less capital, and would thus bring a reduction in the interest rate; and that a decline in the interest rate would shift the demand from labor to capital, and so reduce wages. Under some circumstances this might be true in the short run; but the final adjustments might be quite different and are difficult to predict. A decline in the interest rate, for instance, might lead in the short run to a substitution of capital for labor, or to the addition of more capital and less labor than would otherwise have been used; but in the long run such a decline, with an increased use of capital, usually results in an increase in real wages because the productivity of labor is raised.

Supply of loanable funds. The supply of loanable funds comes from two sources: (1) from savings and (2) from bank loans. Some individuals save part of their income and lend their savings to borrowers, either directly, as on mortgages or other security, or indirectly through banks, depositing them with the banks and letting the banks lend them. The supply of such savings is inelastic in the short run; that is, it cannot be quickly increased or reduced very much. The supply of loanable funds in the form of bank loans, which make up by far the greater part of the total of such funds, is highly elastic, within the limits fixed by reserve requirements. Unless the banks have lent up to these limits, they can and are usually glad to expand loans; and they can always reduce them promptly by calling them in as they fall due.

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[3] Alfred Marshall, *Principles of Economics*, pp. 584, 585.

[4] Frank Knight, *The Ethics of Competition*, p. 262.

Individuals who offer loanable funds in the market must have saved to accumulate those funds, but the banks do not need to save the funds they lend. Nevertheless, the creation of bank deposit money involves saving, not by the banks but by consumers as a class, if there is full employment at the time. Let us suppose that, with full employment in industry, the banks expand deposits through loans to businessmen, who use these funds to build new plants. Who has to save in order that the new plants may be built? Not the banks, but those who would have consumed the goods that would have been produced if the banks had not lent the funds with which the new plant was built. The bank loans enable the men who build new plants to hire away *from other producers* the labor and capital used in building the plants, and so force consumers to get along without the goods which for this reason were not produced. This is one form of "forced saving." If, on the other hand, there were many unemployed workers and idle factories when the banks made the loans, the new plants might have been built without any reduction in the production of other goods, for the necessary labor and capital would have been otherwise unemployed. There would have been no saving. Or, to put it more accurately, if there was much unemployment, the people would already have been saving, in the sense that they were not consuming the goods that the unemployed could have produced but were not producing; and therefore the people would not have to increase their saving.

The loanable funds created by the banks are significant in the short run but not in the long run. In the short run, banks may *increase* loans, create *additional* deposit money, which tends to keep the interest rate down; but in the long run these loans must be paid, and their payment reduces the supply of loanable funds as much as the making of loans increases it. If the banks maintain loans at a fixed level of say 50 billions, the interest rate will be approximately the same as if the banks, under the 100 per cent reserve plan, are forbidden to create any credit at all. In the long run the 50 billions in deposit money merely raises the price level and does not directly affect the rate of interest.

Thus an increase in the amount of bank-created loanable funds is quite different from an increase in the amount of loanable funds arising from increased saving. The latter will not raise the price level but will reduce the interest rate in both the short run and the long run, in the short run by forcing lenders to take less for their funds, and in the long run by increasing the amount of capital and reducing its marginal productivity.

The amount of savings

The amount of savings, and therefore the supply of loanable funds, depends in the long run on the willingness and ability of people to save, and on their willingness to lend what they have saved. It is sometimes said to depend on the "preference for present goods as compared with future goods," or the "impatience to consume"; but this is an inadequate explanation. Savers do not generally balance present against future consumption, or abstain from present consumption in order to consume in the future; if they did so, there would be no permanent addition to capital. If, for instance, a man saves throughout his lifetime to pay the premiums on a life insurance policy, and when he dies his family spends the entire amount of the policy, as they often do, there is no increase in capital, except to the extent that the insurance company makes a profit on the policy and invests that profit in durable capital. It is the savings that are made with no idea of future consumption of the principal itself, those made for the purpose of creating a fund which will be kept intact to yield an income in interest for the indefinite future, that result in an increase in capital.

People are moved to save by many motives other than the desire to consume more in the future—by the desire for security, the itch for the power that wealth gives, family affection and the desire to provide for dependents, and in some cases a broader love of humanity and a desire to be able to promote human well-being in some way; the rich may save because they cannot easily spend all their income. Social habit and convention may be important too. In some communities and in certain countries, the tradition favoring saving is strong, whereas in other communities the general tradition is that of careless spending. The English, Germans, Dutch, French—in short, most Europeans—are savers, whereas tropical peoples are generally improvident. Although this suggests that climate may have much to do with the inclination to save, the question goes too far into the domains of psychology, sociology, and philosophy to be considered here.[5]

The relation of income to savings

But if people are to save, there must be more than a willingness to save; there must be an ability to do so. Only those individuals can save whose income is above what is necessary for the bare essentials of life. The national income has much to do with the volume of savings. For example, savings are greater in the United States than in any other capitalist country, not because we are frugal and thrifty but because on the whole we have high incomes and can save with relatively little sacrifice. People consume more during the prosperity phase of the business cycle than during the depression phase, but they also save more, because they have good incomes and are therefore able to save. On this point Oscar Altman concludes: "The volume of saving is affected much more by a change in the national income than by a change in interest rates. There is always more saving with a high level of national income and low interest rates than with a low national income and high interest rates. The last few years have indicated that even substantial declines in interest rates at levels of national income characterized by considerable amounts of unemployment have been unable to affect any decline in the rate of saving."[6]

The supply of savings, and therefore of loanable funds, is highly inelastic at ordinary rates of interest. At one time almost all economists believed that the supply was fairly elastic, that the amount of savings was considerably affected by the rate of interest; but at present this is not true. The amount of savings is very inelastic because most of the savings are made by the rich, by corporations, by insurance companies, and by the government, none of which save much more at high interest rates, or much less at low rates. We must now consider the savings of each of these.

Savings by the rich

Most of the savings are made by the rich and well-to-do. The percentage of income saved rises steadily with increases in income. In 1935–1936, according to the National Resources Committee, the 23 million families and single individuals in this country who earned less than $1250 a year saved less than nothing, while the 110,135 families and individuals earning $20,000 and over saved more than 50 per cent of their income. The 927,000 families and individuals with incomes above $5000, less than 3 per cent of the population, provided 79 per cent of the total savings.[7]

That the rich do most of the saving is indicated by the fact that profits, which go largely to this class, are the source of a large proportion of the total savings. Profits constituted only 10 per cent of the national income in the prosperous year 1929, but they were responsible for 46 per cent of our total savings. Although they form a smaller proportion of the national income in depression years, they still provide a substantial proportion of the total savings. Of similar significance is the fact that corporations account for a large proportion of all savings and that their stocks are for the most part owned by the rich and well-to-do.

Since the rich save a much larger proportion of their incomes than the poor or middle classes, there is some reason to believe that, in the past, the high degree of concentration of wealth and income *may* have resulted in a more rapid accumulation of capital and a lower rate of interest than would have been possible with a more equal division of income. Much of our productive capital—most of our railroads, mills, factories, refineries, smelters, ships, warehouses, and department stores—has been built by the rich. In some cases the money was secured by selling stock to the public, but the well-to-do and rich generally bought most of the stocks. If the rich had had less income, perhaps we should have less productive capital.

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[5] See *ibid.*, chap. 10, particularly p. 263.

[6] Temporary National Economic Committee, *Monograph No. 37*, p. 26.

[7] National Resources Committee, *Consumer Expenditures in the United States*, p. 48; Temporary National Economic Committee, *Monograph No. 37*, pp. 16–18.

It is not certain, however, that if our wealth and income had been more equally divided we should have less wealth. We might have fewer railroads and factories, but we might have more wealth on the farms and in the homes of the laboring and middle classes; the masses of the people might be better fed, better housed, and better educated; and the total productivity of the country's labor and capital might be as high as it now is, or possibly even higher. According to Marshall, "The older economists took too little account of the fact that human faculties are as important a means of production as any other kind of capital; and we may conclude, in opposition to them, that any change in the distribution of wealth which gives more to the wage earners and less to the capitalists is likely, other things being equal, to hasten the increase of material production, and that it will not perceptibly retard the storing-up of material wealth."[8] In recent years certainly, more wealth would be produced if there were a more equal distribution of income, for one of the reasons why it is often impossible to keep our factories busy is that the people who need goods do not have a large enough share of the income to buy the full output of the factories. With more equal distribution the interest rate would probably be higher, however, for more of the savings would be made by people for whom saving involves real sacrifice.

The fact that the rich do most of the saving, and at little or no sacrifice, is in some respects unfortunate. It is a hardship for the poorer classes that for their meager savings, which are made at heavy sacrifice, they can get only the same interest rate, or indeed generally less, than those receive whose savings are made at small sacrifice, or none at all. As Altman says: "It is a paradox that those with small incomes, who find it hardest to save, receive the smallest net returns upon their savings. Any comparison of the cost of industrial insurance with that of ordinary life insurance makes this cost differential painfully obvious. Those with the largest incomes, those who find it easiest to save, those whose saving is to some degree automatic, receive the highest rates of return upon their saving not only because they employ low cost methods but because they have access to the best information and the high yield opportunities."[9]

Savings by corporations

Savings made by corporations are also little affected by the rate of interest. It has long been the policy of the Standard Oil companies, for instance, to pay their stockholders only part of the earnings, and to set aside the rest as surplus to be spent in expanding the productive equipment, regardless of the interest rate. Such savings are often called compulsory because the stockholders are compelled to save part of the income that their capital has earned. More than 2 billion dollars was set aside in this way by American corporations in 1929.[10] During the period 1930 to 1939, 58 large industrial companies invested more than 5 billion dollars in plant and equipment, 90 per cent of which came from their own savings.[11]

Savings by insurance companies

Savings made through life insurance companies are affected very little or not at all by the rate of interest, and it is not even certain in what direction; that is, it is not certain whether a high rate increases or reduces the amount of saving. We may distinguish two ways in which the life insurance business results in saving. In the first place, some of the insurance companies make handsome profits by charging the policyholders more than enough to cover the expenses of the business; and these profits go largely to wealthy officers and stockholders, who save a large proportion of them, regardless of the rate of interest. In the second place, insurance is a means by which the policyholders save. For them the saving is in a sense compulsory, like the savings made by corporations, for the holder of a policy must pay the premiums regularly; and there is no reason to believe that his willingness to take out a policy or to keep up his premium payments is affected much by the rate of interest which they earn. If a policyholder dies at or before the average age of death, the amount his beneficiary receives is greater than his total premium payments, and the excess represents interest on the premiums that he has been paying; but very few policyholders would be able to reckon the interest rate, even if they had any curiosity regarding it.

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[8] Alfred Marshall, *Principles of Economics*, pp. 229–230.

[9] Temporary National Economic Committee, *Monograph No. 37*, p. 27.

[10] Maurice Leven, Harold Moulton, and Clark Warburton, *America's Capacity to Consume*, p. 98.

[11] *American Economic Review*, Supplement, Papers Relating to the Temporary National Economic Committee, June, 1942, p. 78.

The rate of interest may affect the amount of insurance saving slightly, but it is difficult to say in what direction. If the rate declines, the insurance companies will receive lower returns on their investments and will have to charge higher premiums, which may conceivably result in a slight decline in the purchase of new policies. But those who already have policies will pay higher premiums and will have to save more, unless they let their policies lapse—and few would drop their policies for this reason, certainly. How the various factors would balance up, it is impossible to say; but it is clear that the interest rate has no great effect on insurance savings. Buyers of insurance policies seldom calculate costs; most of them take out policies under skilled sales pressure or because they are friends of the agent or because it is the only way to get rid of him, and not as the result of careful study of the terms in the policies.

Savings by the government

A fourth class of savings made without much regard for the rate of interest is represented by those of the government. Governments have been responsible for a fairly large percentage of the savings made in the past; or perhaps it would be better to say that governments have been the agencies through which people have saved. As indicated in an earlier chapter, the pyramids of Egypt, the temples and monuments of antiquity, the roads and aqueducts of ancient Rome, the castles and cathedrals of medieval Europe, and the roads, bridges, and public buildings of today all represent the savings of the people, compulsory in the case of despotic governments, and compulsory too in the case of democratic governments, although decreed by a majority vote of the people. It has been estimated that during the prosperous period from 1925 to 1929, federal, state, and local governments accounted for about 22 per cent of all net savings. Under the New Deal, the federal government spent billions in reforestation, erosion control, road building, rural electrification, and the construction of hydroelectric dams and public buildings; but since unemployed labor and capital were used in these projects, they called for little or no saving by the people.

Conclusions

Not all the savings we have discussed here appear in the form of loanable funds. The savings of the rich, and some of those of the insurance companies do, but corporation savings and government savings may never appear in the loan market. Nevertheless, the latter have the same effect on the rate of interest as if they took the form of loanable funds. It makes no fundamental difference in the process of capital creation whether a corporation builds a new plant from its own savings—really the savings of its stockholders—or whether it borrows the savings of others in the loan market; in each case saving results in an increase in the amount of capital.

Our conclusion must be that the amount of savings is highly inelastic—that it does not vary much with changes in the interest rate. Altman's opinion on this question is based on careful study: "Even with any given national income, concentration of income, and tax structure, it must not be assumed that savings increase as rates of interest increase. It may be true that some individuals will save more at a given level of income when interest rates rise, but others who have agreed to save through life insurance and other contractual plans may unnoticeably be finding themselves saving less. On the other hand, as interest rates fall, dividends on life insurance contracts decrease, and policyholders are expected to increase their premium payments. It is unlikely that these increases in premium payments are offset in full by decreases in other forms of saving."[12]

It is probable, however, that extremely low or high rates would affect savings somewhat. Some savings would indeed be made if the interest rate were zero or even negative, that is, if savers had to pay for the care of their savings. Many people of moderate means would save something to provide for their families, to protect themselves and their families against the proverbial rainy day, or to insure funds for a top-notch funeral. It is doubtful whether most small savers receive any net interest on what they save anyhow. Some do, of course; but so many others lose their savings in unwise and unfortunate investments that the net average interest they receive may well be less than nothing. Many of the rich would save a great deal even if they received no interest, and there would be considerable savings by corporations, insurance companies, and the government. In the years preceding the Second World War, the rate of interest declined to the lowest point in history, less than 1 per cent on some short loans, and Keynes predicted that after some years of peace it might actually reach zero. Even at the very low rate prevailing, the country's savings were fairly high. It is probable, nevertheless, that a zero or negative rate of interest would reduce savings somewhat; and, on the other hand, it is likely that a very high rate—6 or 7 per cent on prime bonds—would increase savings considerably. We cannot be very sure about all this, but perhaps we might draw the supply curve for savings, and for loanable funds, as in Fig. 39.

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[12] *Ibid.*, p. 26.

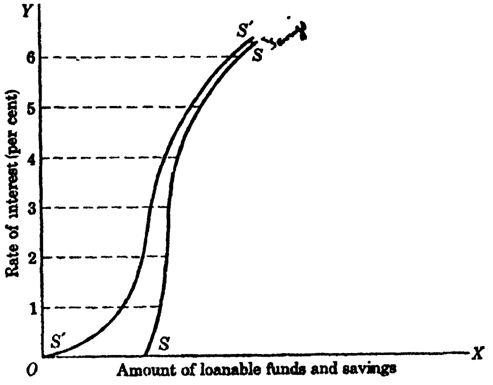

Fig 39.

In this figures SS is the supply curve for savings, and S′S′ is the supply curve for loanable funds. At every interest rate the amount of loanable funds supplied is smaller than the amount of savings by the amount hoarded, indicated here by the distance between the S′S′ and SS curves; and the amount hoarded increases with a decline in the rate of interest, until at zero interest all the savings are hoarded. There would be no advantage in lending savings if no interest were paid.

Combining the demand curve, drawn as unity—that is, as a rectangular hyperbola—with this supply or cost curve, we arrive at the final supply and demand equation for savings and for loanable funds, shown in Fig. 40. The supply curves for savings and for loanable funds, SS and S′S′, are the same here as in Fig. 39. The demand curve cuts the S′S′ curve at *a′* to fix an interest rate a little below 2 per cent, with *Oa* units of loanable funds demanded and supplied, and *ab* units of savings hoarded. If all the savings had been offered in the loan market, the interest rate would have been about 1½ per cent, and the amount demanded and supplied would have been *Ob*.

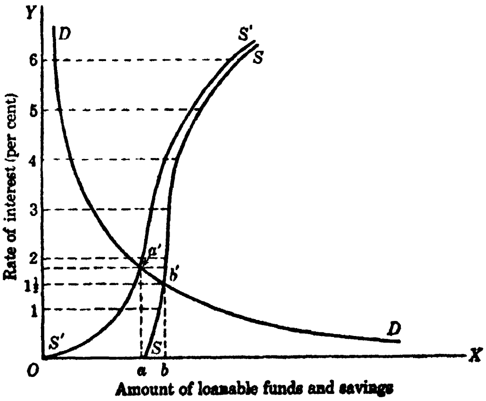

Fig. 40.

Government fixing of the interest rate

Some followers of Keynes believe that the government can fix the rate of interest successfully. It can do this in the short run by manipulating banking and credit policies; this has often been done in wartime. The long-run rate, however, can be influenced appreciably only by measures which affect the demand for or supply of loanable funds, or by policies which affect the people's ability and inclination to save, and therefore the supply of savings, or by measures which affect the people's liquidity preference. Cost of production is the important factor here, as in long-run price generally. Government insurance of bank deposits would presumably encourage savings, increase capital, and thus tend to lower the interest rate. If really effective, the regulation of the issue and sale of securities to protect investors from misrepresentation would have the same tendency. Any government policy, positive or negative, which increases the people's confidence in investments will have the effect of increasing savings and lowering the interest rate; any policy which raises the average income of the people will tend to increase savings by making greater savings possible, and so will reduce the rate of interest; and a policy of penalizing hoarding will increase the supply of loanable funds and reduce the rate of interest.

Usury laws

From the preceding analysis it should be clear that laws which establish maximum interest rates can have only a very limited effect. High rates of gross interest usually indicate great risk; and, by putting a certain stigma on those engaged in making such loans, legislation fixing lower rates is likely, if not evaded, to reduce the amount of loans available and thus actually increase the rate.

The interest rate under monopoly

Our analysis of the rate of interest has been based on the assumption of competition; but to the extent that monopoly exists, either in the goods markets or in the loan market, the analysis will have to be modified. All urban industries, as we have seen, are more or less touched by monopoly in the goods markets, and this affects both the demand for loanable funds, and therefore for savings, and the supply of them. Since the monopolies restrict output and so reduce the amount of capital needed in the monopolized industries, they reduce the demand for loanable funds there; but they may increase the demand in the competitive industries because by restricting entry into the monopolized industries they force entrepreneurs into competitive fields of enterprise. The latter are not as profitable as they would be if there were no monopoly in the economy; they suffer from the skimped output and high prices of monopolized goods, and from an oversupply of labor and capital and consequent low marginal productivity; nevertheless, having a larger amount of productive resources, the competitive industries may need and demand more loanable funds. Doubtless, however, monopoly reduces the demand for loanable funds in the monopolized industries more than it increases the demand in the competitive industries, and therefore it reduces the total demand.

On the supply side, it is probable that monopoly in the goods markets increases the supply of loanable funds and of savings. Monopolies often make handsome profits, the only pure profits that persist in the long run, since competitive industries operate at cost; and these profits are paid largely to people with high incomes, who are likely to save a considerable proportion of them.

Our conclusion is then that monopoly probably reduces the demand for loanable funds and increases the supply, and in both ways reduces the rate of interest. We cannot be entirely certain about this, but in the light of conditions in recent years it seems a reasonable conclusion. It may explain in part the vast amount of savings in recent years and the extraordinarily low rate of interest. If the monopolized area of the economy were competitive, open to all, there would be a greater demand for loanable funds, savings, higher marginal productivity of labor and capital, and a higher interest rate.

Monopoly in the loan market

Monopoly in the loan market calls even more clearly for modification in our analysis and conclusions. We have assumed pure competition in the loan market in which the rate of interest is determined, but we must now modify that assumption, for the loan market by no means represents pure competition. For example, in the chapter on monopoly we saw that the investment bankers who provide the funds for large business corporations usually do not compete aggressively but employ market sharing to avoid competition. The banking business generally is far from perfectly competitive. Many small towns have only one bank; larger towns and cities generally have two or more, but the various banks usually have agreements and understandings of various kinds, in some cases negotiated through the clearing houses, to insure "cooperation on all matters of common interest," one of which is the interest rate paid on deposits and another the rate charged borrowers. These rates have many of the earmarks of monopoly prices. Although the interest rate on "wholesale money," that is, funds available in the New York money market, declined more than 50 per cent between 1920 and 1935, many banks reduced their rates to small borrowers very little if at all. If the wholesale price of groceries had declined similarly and the retailers had maintained their prices unchanged, we should have assumed that there was a copper-riveted monopoly in the grocery business, as indeed there would have been.[13]

Large corporations with a high credit rating are usually able to secure capital at a rate which approximates its marginal revenue productivity, in some cases at less than 4 per cent. In selling bonds or stocks through investment banks, they pay a commission which, while often highly remunerative to the banks, may be as low as 1 per cent. Because of their high standing in the business world and the large scale of their business, they can secure funds for about what they are worth. In bank loans to small borrowers, however, there is no such approximation of interest rates and marginal productivity of capital. For several years before the Second World War the rate of interest on gilt-edged long-term bonds was only about 3 per cent, or even less, which indicates that the marginal productivity of capital was not above 3 per cent; yet the banks commonly charged small borrowers from 6 to 8 per cent. It is not surprising that the banks found it difficult to make loans, or that small business is yielding steadily to big business. Big business enjoys a great advantage in the loan market.

Nor is there any identity between interest rates and marginal savings in bank loans to small borrowers. Marginal savings are fixed by the rate which savers can get for their savings, not by what borrowers have to pay. In recent years savers have been able to get only about 3 per cent, or less, on gilt-edged bonds, and perhaps 4 or 5 per cent on mortgages, whereas small borrowers have paid from 6 to 8 per cent. This is far from a purely competitive market. In a purely competitive market *one* price is fixed, at which sellers can sell and buyers can buy; in the loan market, as far as that is represented by small borrowers on the one hand and by banks on the other, the sellers must sell at 3 per cent and the buyers must pay at least 6. This is of course not a market at all, as economists use the term.

The foregoing must not be construed as altogether a condemnation of banking practices, for banks have always operated in this way; and while they do sometimes take advantage of their strong and to some extent monopolistic position, they could not well operate as purely competitive businesses.

QUESTIONS

1. Define interest. What elements does gross interest include that net interest excludes? Why does net interest tend to equality everywhere, whereas gross interest varies widely?
2. What justification was there for the medieval prohibition of taking interest? Criticize the justification usually offered by the writers of that period.
3. Why *must* interest be paid? Why *can* it be paid?
4. A borrower pays off a $1000 debt by paying $12 a month for ten years. What rate of interest is he paying?
5. If the United States lost one-half of her present supply of gold, what would be the long-run effect on the rate of interest?
6. If a bond and a stock were equally safe, which would you prefer as an investment, in a period of falling prices? In a period of rising prices? Why in each case?
7. Why, in our modern economy, do savings appear to be little influenced by the rate of interest?
8. The Grand Coulee Dam was built at a time when there was considerable unemployment of both labor and capital. Who saved in order for this addition to capital to be made?

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[13] On this subject, see Lester A. Chandler, "Monopolistic Elements in Commercial Banking," *Journal of Political Economy*, February, 1938, p. 1.

9. According to T. N. Carver, "Interest does not correspond to any general discounting of future consumption of commodities, but only to the marginal discount or to the marginal sacrifice of saving. It must be sufficient to compensate the capitalist for saving the last increment of capital." Draw a graph to illustrate this, and from it appraise the significance of the word "must" in the last sentence.
10. If every person made and used his own tools, would there be any interest?
11. Owners of forest lands often cut the trees and let the land lie idle, without troubling to provide for a new stand of trees. Why? Has the interest rate anything to do with this practice? If they could get loans for reforesting their land without any interest charge, would they provide for reforestation?
12. Draw a graph showing the relation of the interest rate to the marginal demand for loans and the marginal savings.
13. If our wealth were more equally distributed, in what form would we have more wealth, and in what form would we have less?
14. Does the supply of capital in the form of hotels, apartments, railroads, etc., have anything to do with the rate of interest? If half our physical wealth was destroyed in some way, what would be the effect on the rate of interest? Why is the interest rate high in Russia? What effect should the destruction of so many houses in Europe during World War II logically have on the interest rate?
15. What do you think is the reason for our low interest rates during the past ten years? If vast new deposits of oil, gas, copper, lead, and zinc should be discovered within the next year, what would be the effect on the rate of interest? Why? Why, until recently, was the rate of interest higher in the United States than in Holland, Belgium, or Switzerland?
16. A farmer saves $1000 and spends it on building a silo, which does not increase his output at all. Is the silo capital?
17. How does an increase in the amount of capital affect the marginal productivity of labor, the labor supply remaining unchanged? How does an increase in the supply of any of the three factors of production—land, labor, and capital—affect the marginal productivity of the other two?
18. The rate of interest, like any other price, cannot decline below the cost of production of capital. What is the cost of production of capital?
19. If everyone had spend his entire income for consumers' goods since Washington's time, how much capital would there be in the United States?
20. "The rates at which different people discount the future affect not only their tendency to save, as the term is ordinarily understood, but also their tendency to buy things which will be a lasting source of pleasure rather than those which give a stronger but more transient enjoyment." Give examples to illustrate this.
21. If the country's agricultural and retailing businesses became monopolized, what would be the effect on the rate of interest? Why?
22. Suppose the interest rate doubles. What would be the effect, other factors remaining the same, on the price of farms, stocks, bonds running two years, and bonds running fifty years?

Chapter 30.

Rent

Rent defined

Like many other terms in economics, the word rent is used in different senses. Until rather recently, it was defined as *the income accruing from the use of land,* land being the gifts of nature, such as farm land, urban land, mineral resources, and the like. The rent on farm land was assumed to include only what was received for the original properties of the soil, not what was received for the fertilizer added, or for the buildings or fences, because these were added by man and not by nature. Similarly, the rent on urban land was assumed to include only the income received from the use of the land, the "standing room" for the building; the income from the building itself was excluded.

In recent years some economists have greatly extended the concept of rent. Boulding, for instance, defines economic rent as "any payment to a unit of a factor of production, in an industry in equilibrium, which is in excess of the minimum amount necessary to keep that factor in its present occupation."[1] According to this definition, any wages received by a laborer above the minimum amount that would induce him to work at his job is rent; any interest received by a saver above the amount which would have induced him to save is rent. This is a perfectly logical definition of rent, if it is used consistently; but, for reasons which will presently appear, we shall define rent in this book as the income accruing from the use of land.

Income, as used here, may be in the form of farm *products* from farm lands; in the form of *facilities* for retailing, wholesaling, banking, manufacturing, or residence, in the case of urban lands; in the form of timber, oil, gas, coal, or other minerals, from forest or mineral lands; or in the form of electric current from water power. In all cases, the rent, which in this sense is called *economic rent,* is the amount of farm products, of marketing or other business facilities, of timber, minerals, or water power, produced by a given amount of labor and capital applied to a given tract of land or mine or water-power site, over the amount produced by the same investment of labor and capital employed on a marginal tract of land or mine or water-power site, that is, on one which will produce only enough to yield cost of production and can therefore be had free of rent.

If a farmer with say $3000 in labor and capital can produce 3000 bushels of wheat on a good farm in Iowa, and only 1000 bushels on a no-rent farm in eastern Colorado, then 2000 bushels of wheat is the *economic rent* of the Iowa farm; if a coal miner, using a given amount of labor and capital, can produce 2000 tons of coal in a rich mine, or 1000 tons of coal in a marginal no-rent mine, then 1000 tons is the economic rent of the rich mine. Economic rent is thus a *surplus* above cost of production, the cost excluding rent. In the oil business the royalty, ordinarily one-eighth of the oil produced, may well be regarded as economic rent paid to the owner of the land; but this rent differs from the rent of a good farm or an urban site in the important fact that it will not last indefinitely, since the oil is being used up.

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[1] Kenneth E. Boulding, *Economic Analysis,* p. 229.

The term economic rent is often used also to indicate the *money value* of this surplus of products or services; and where it is so used, it varies with the prices of the products or services. In this sense, if the price of wheat rose from $1 to $2 a bushel, the economic rent on the Iowa land mentioned above would rise from $2000 to $4000. In this book, unless specifically indicated to the contrary, we shall use economic rent to indicate the money value of the surplus products or facilities.

The term *business rent* is used to indicate the amount actually paid for the use of land. If rent were determined from day to day, in a perfectly competitive market, by many perfectly wise and rational bidders, business rent would always be the same as economic rent, for tenants would pay business rent that exactly equals the value of the products or facilities over the value of the products or facilities yielded by no-rent land. They could not afford to pay more, and competition would force them to pay this much. For various reasons, however, business rent may be either below or above economic rent. In the first place, contracts for urban land rental are often drawn for long periods, sometimes as long as 99 years, at a fixed rent per year. During the first few years of such a contract, the business rent is likely to exceed the real productive value, or economic rent; and later, if the city grows, it is likely to be much below the economic rent. Contracts made in periods of prosperity may call for payments which during a later depression prove to be greater than the economic rent earned by the land; similarly, contracts made during a depression may call for payments which prove later to be much less than the economic rent. Farm rental contracts often call for rent payment in the form of a share of the crops rather than cash; and the amount and value of share payments of course vary with production and the prices of products. The terms of these share-rent contracts change slowly with changes in economic conditions, and the rent paid often remains for years below or above the true economic rent. Between 1914 and 1920, for instance, the prices of farm products, and the true economic rent, rose rapidly, but many rental contracts changed little or none at all; and in the later part of that period many landowners doubtless received less than the true economic rent. In the period from 1920 to 1932, this situation was reversed.

In the second place, the owners of land and the bidders for it in the rent market may make mistakes, may set a business rent that is either above or below the economic rent at the time. In the third place, owners of high-rent urban sites are probably able at times to appropriate more than the true economic rent by taking from the entrepreneurs who are using the land some of the income which should go to them as profits. Paul Nystrom has shown that business rent increases relative to profits from smaller to larger cities and from poorer to better locations in a given city, and from this he concludes that landowners absorb a part of the profits of the superior entrepreneurs.[2] There may be some truth in this. It often happens that an able entrepreneur leases a given site for a term of years, builds up a good business, and attracts a large number of customers, with the result that when his lease expires the landowner raises his rent and takes away part of the profits accruing from his good management. Many capable managers who operate on high-rent urban sites may thus lose to the landowners part of the income they have earned by their energy and competence.

Distinction between land and capital

Some economists deny that there are any valid reasons for distinguishing land from capital or rent from interest. They maintain that to the individual businessman or farmer an investment in land is just the same as an investment in capital. If economics were concerned only with men as individual producers, this view would perhaps be sound; but economics is concerned mainly with the broader aspects of business life, and not with men in their individual capacities.

That land is not *absolutely* different from capital but shades gradually into it, and that there is no such thing as a pure gift of nature since man has to make some contribution to every natural gift before it can be of use, we have already pointed out. Yet there are good reasons for distinguishing between land and capital, and between rent and interest. Nature has contributed much more to the value of some things than others; and to this extent, as we shall presently see, we may wisely adopt a different policy with respect to them. We cannot refuse to make any distinction between land and capital because they are only relatively and not absolutely different, for most distinctions in economics are relative rather than absolute, and we must constantly make distinctions if we are to formulate any scientific principles.

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[2] Paul Nystrom, *Economics of Retailing*, chap. 8.

As a practical problem, it is much easier to separate land from capital, rent from interest, in cities than on farms. Urban land is valuable, productive, not because of its soil fertility, which man might improve, but because of its "extension," because it affords a certain amount of standing room which man cannot change. Urban business buildings are often built on rented land, the builder paying the landowner a stipulated rent for the use of the land for a certain number of years and surrendering the building at the end of that period. The landowner provides only the land—standing room—which is a gift of nature, and what he receives is business rent. Ordinary business operations thus separate business rent from interest on leased land; and it would not be very difficult for real estate experts to figure out the rent on other urban lands with reasonable accuracy.

Nature's contribution and man's contribution are more difficult to distinguish on farm land. It is easy to distinguish the land from the fences and improvements, but the productive value of every farm depends to some extent on its accessibility, that is, its distance from the markets and on the character of the roads leading to it. Thus its location may be said to be a gift of nature, like the location and extension of urban land; but the roads are of course the product of man, although not primarily of the owner himself. The productivity of the soil of any old farm is partly the result of nature's generosity, and partly the result of man's contribution in the form of drainage and fertilizers; and the amount attributable to each cannot be calculated with much exactness. The rent of a farm is therefore not all true rent but a mixture of rent and interest, difficult to distinguish.

Quasi-rent

Much like land rent in some respects is the income from certain kinds of capital—"old investments" of capital, as Marshall describes them—and from certain human talents which are in a sense natural gifts. Old investments of capital, such as durable buildings and machinery, railway roadbeds and tracks, and perhaps the more durable rolling stock, are like land in many ways, and the income from them is a quasi-rent, similar to true rent. Such fixed capital is not a gift of nature; but, once built, it may be considered much the same as land. Like land, it is durable; like land, it cannot be moved directly; like land, it yields an income which depends largely on its location. It may seem fanciful to think of human talents as land or even as resembling land, but we may do so with perfect logic, as we have already pointed out. The income from human talents is in the nature of rent—a quasi-rent—on natural gifts.

Demand and supply in rent determination

Like any other price, rent is determined by the general conditions of demand and supply; but there are important peculiarities in applying the law of demand and supply to rent determination. In the first place, we do not need to make any distinction between the short and the long run, because since land is provided by nature, the supply of any particular grade is practically fixed, and there is therefore no necessity for considering long-run cost of production of it. In the second place, the land market is a rather imperfect market, because land is more heterogeneous than many commodities, or than capital or even labor. It will be recalled that a perfect market demands, among other things, (1) a large number of units of an identical product for sale, and (2) a large number of buyers and sellers. The land market has neither of these requisites. Land is highly heterogeneous, that is, every business or residence site is slightly different from every other one; usually there are only a few units for rent in a given market at a given time, and usually there are only a few buyers and sellers. The land market, even for land of a particular grade, is far from a perfect market; and for land in general, of all kinds and grades, there is of course no market at all, but an almost infinite number of markets.

The demand for land a composite demand

The demand for land is a "composite" demand composed of the demands of all those who want land for the various uses to which it can be put. In the competition of the market the highest use, that in which the land will produce the greatest return, will take the land; hence land tends to be devoted to its highest use. In this respect the land market is like the labor market.

The supply of land

On the supply side, land differs from the other agents of production. As a gift of nature its total supply is fixed, as we have already seen; but this characteristic is subject to important qualifications. In the first place, the amount of productive land *available* may be reduced or increased by man. Fertile, sloping land may be ruined by erosion and even level land may be robbed of its fertility by improper use; and on the other hand, land that is unproductive in its natural state may be made productive by fertilization, irrigation, or drainage. Such land represents a combination of land, in its strict meaning, and capital; but once the capital has been added, it partakes of the nature of land, and for many purposes may be regarded as land. For instance, drainage ditches and tile, once put in on waterlogged land, become an inseparable part of the land, fixed, unmovable, and highly durable. In the second place, although the total amount of land is practically fixed and the amount of any given grade is fixed, the amount of land *available for any particular use* may be increased. An increased demand for wheat would not run into a fixed supply of wheat land, for land used for other crops can be turned to wheat production; but an increased demand for *all* farm products could not be met in this way. And, in the third place, although the total area of the country is fixed, the amount of land available for urban uses is indefinitely expansible.

The equation of demand and supply

The demand and supply curves for land of any particular grade may be drawn as shown in Fig. 41. Here the rent is determined by the equilibrium of demand and supply, but changes in rent can result only from changes in demand, which in turn are the result of changes in the demand for the products or services of the land.

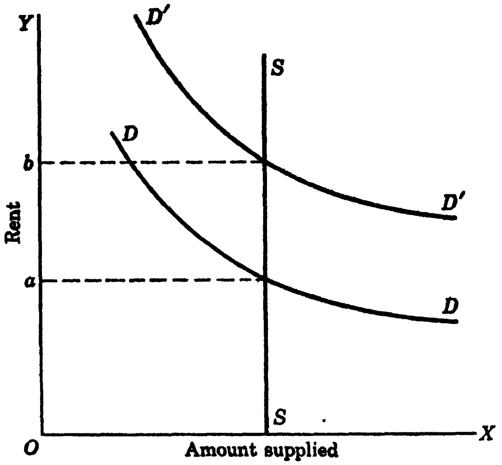

FIG. 41.

Marginal productivity and rent

The amount of rent that will be paid for the use of a particular grade of land is sometimes said to depend on the marginal productivity of that grade of land. According to this theory, a farmer is assumed to keep his labor and capital constant, subtract one or a few acres from his farm, and note the amount by which his total product decreases, or add one or a few acres and see how much his total product increases. The amount of decrease or increase is the marginal productivity of that grade of land. This measures the rent. If, for instance, an added acre of land raises the total product by 20 bushels of wheat, 20 bushels of wheat is the marginal productivity of the land and is the rent, in product. If wheat is worth $1 a bushel, the money rent will be $20.[8]

This analysis is the same as that used in our discussion of wages and interest. It is one illustration of the general principle of variable proportions, or diminishing productivity. As a corollary to this analysis, it is clear that the entrepreneur will expand his use of each factor —labor, capital, and land—to the point where a given amount expended for each yields the same addition to his net revenues.

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[8] One of the best analyses of this principle is to be found in F. B. Garver and A. H. Hansen, *Principles of Economics*, rev. ed., pp. 425, 426.

Rightly understood, this analysis seems valid, but it does not include all the elements necessary for a complete theory of rent. For one thing, the operations of one farmer do not, of course, have any appreciable influence on rent, which is determined by factors that are operating throughout the entire field of the demand for and the supply of land. Even if we expand the analysis to take in all the farmers using a given grade of land, it is still inadequate, for a complete theory of rent must include some consideration of all grades of land. Furthermore, if this theory be construed to mean that the rent of a given grade of land is *determined by* its marginal productivity, this involves incorrect statement or incorrect reasoning. The marginal productivity, in the sense of the amount referred to, does indeed measure the rent but it does not determine it, for rent is *determined* by the general conditions of demand and supply, which also determine the marginal productivity.

Location rent

Farm rents do not result entirely from superior fertility, for location is also an element in rent determination. Economists sometimes distinguish between fertility rents and location rents. If all farm lands were equally fertile, the land which is nearer the market would command a rent premium over that which is farther away, a premium equal to the difference in the cost of transporting the produce to market, plus an additional amount for the greater convenience of living near urban centers, because farms are used not only to produce crops but as homes. Europe has been our greatest market for many farm products; hence prices for such products are highest along our Atlantic seaboard, particularly New York, and they shade gradually lower from there westward, with the result that rents for farm land of equal fertility decline generally from the eastern seaboard to the Central West. Somewhat the same decline may be seen from our west coast ports into the interior western states, to the "divide" which separates the westward-flowing from the eastward-flowing traffic.

The extensive margin of cultivation

Ricardo's conception of rent as the difference between the product of superior land and the product of marginal or no-rent land has been accepted by almost all economists. It is clear that this differential can and must be paid by the users of the good land. It can be paid because a given amount of capital and labor will produce this much above what the same amount of capital and labor would produce on marginal land. The farmers who cultivate the superior land can pay this differential and still make as much as they would if they farmed marginal land. This differential must be paid because there are many competitors for the superior land, and they will bid it up to that point. The margin referred to here is the *extensive* margin, the margin represented by the no-rent land which yields barely enough to cover cost of production, which is barely worth cultivating.

It should not be assumed that this margin has anything to do with the determination of rent. The rent is not determined by the margin or by the cost of production on marginal land; it should rather be said that both the rent and the margin are determined by the general conditions of demand and supply. Changes in one or both of these conditions will cause changes in rent and shifts in the location of the margin. Thus, during the First World War, when the prices of farm products rose rapidly, rents increased and the margin shifted outward to land which was formerly not worth cultivating; and the price decline which followed that war brought rents down and caused an inward shift of the margin, with abandonment of the poorest land then under cultivation.

Nor should it be assumed that marginal land is necessary to the measurement of rent. In every country there is some land that may be regarded as marginal and submarginal; but even if there were no such land there would nevertheless be rent. If land were scarce, rent would rise even higher than it does where there is inferior land which can be brought into use in response to higher prices of farm products. If there were no inferior land, prices of products would of course rise higher, and rent would be higher. The rent, under such conditions, would be determined by demand and supply, without reference to any marginal land, and it might be called scarcity rent rather than differential rent. All rents, however, are really scarcity rents, for they are paid because land is scarce; and they might appropriately be called differential too, because, even if there were no marginal land, rents would differ with the productiveness and location of the land.

A serious difficulty with the concept of the margin is that it assumes all the land to be used in producing the same crops. Actually there are many different uses to which different grades of land are put; there is generally a different margin for each use, and only the land which is marginal for the lowest use is marginal in the sense that it yields no rent. In Kansas, for instance, a small amount of the best land is used for production of potatoes; land which is marginal for potato production may yield a fairly high rent in corn production; marginal corn land, again, may yield a rent in wheat production; and marginal wheat land usually yields a rent for grazing. Thus land which is marginal for every use but the lowest will yield a rent.

The same analysis applies to urban land. Urban land which is marginal for retailing, generally the highest use, may yield a rent for wholesaling; land which is marginal for wholesaling may yield a rent for apartments; land which is marginal for apartments may yield a rent for residences; and land which is marginal for residences usually yields a rent in farming. As a rule there is no no-rent land in the city, but there are fringes of land which are marginal for each use.

The intensive margin of cultivation

The extensive margin is not the only margin which must be considered in the analysis of rent. There is also the intensive margin, which may be defined as *the point in the cultivation of a given piece of land at which the labor and capital used barely pay their cost.* In a country where cultivation has passed the point of diminishing returns, successive applications of units of labor and capital will yield diminishing returns. With the prices of farm products at a given level, a certain number of units of labor and capital applied to a given piece of land will yield more than their cost, this surplus going to the landowner as rent; but in adding units of labor and capital the entrepreneur will finally reach a point at which the last units applied yield barely enough to pay their cost. This is the intensive margin. The yield of labor and capital at this margin and at the extensive margin, on marginal land, will be the same. If the yield at the extensive margin were greater, farmers as entrepreneurs would devote labor and capital to the cultivation of still poorer land, would force the extensive margin outward; and if the yield of labor and capital on the intensive margin were to exceed that on the extensive margin, they would devote more labor and capital to the superior land, cultivate more intensively. The yield of labor and capital on the two margins must be equal.

Rents, population changes, and scientific progress

The principles analyzed here apply to rents at a given time with a given population and at a given stage of scientific and technological development. It will be pertinent now, however, to consider some of the changes in demand and supply that may come with population changes and with scientific and technological progress.

Population changes and farm rents. An increase in population, if the point of diminishing returns has been reached, tends as a rule to increase the demand for farm products, to raise their prices, and to raise farm rents. But higher prices for farm products do not necessarily raise rents. If, for instance, such a price rise were accompanied by a proportionate rise in the costs of production—that is, in wages, interest, and the prices of the machines and materials used in farming—rents might not rise at all. This situation often appears during a period of rising prices. Rent is a surplus above costs; and if costs rise as much as prices, rent will not increase at all. Generally, however, other conditions remaining the same, higher prices for farm products will raise rents and will cause shifts at both the extensive and the intensive margins of cultivation. The manner in which these shifts are caused by price changes has already been explained in the chapter on long-run competitive price.

Population growth and urban rents. A population increase raises urban rents too, but in a different way. With the increase in population in the United States, the number of urban dwellers has increased much more rapidly than the number of farmers; the latter in many rural areas has indeed been declining for several decades. This population growth has increased the demand for the facilities afforded by urban lands, has raised the rents of well-located sites in large cities to fantastic heights, and has pushed the margin outward around the city, but has not raised the costs of urban business. This was explained in Chapter 2.

Scientific and technological progress and farm rents. Increase in scientific knowledge probably tends to reduce the rent of agricultural lands. Advancing knowledge of plant and animal breeding, for instance, tends to increase production; and since the demand for most farm products is inelastic, it tends to reduce prices disproportionately and in general to reduce rents. The truth of this will be apparent if we imagine the improvements carried to a point where all the farm products wanted could be produced on half of the best land. This would amount to an evasion of the law of diminishing returns, and would eliminate fertility rent even on the best farm land.

Technological improvements in farming may affect both the demand for land and the supply of available land. The amount of land of any given grade is fixed, but the amount available for use may be increased in various ways. Let us suppose that a new type of farm tractor is introduced which reduces the costs of producing crops. Its first effect would be to raise the profits of farm operators; but this could not last, for it would create an increased demand for land, which in turn would raise rents. If the decrease in costs did not increase production and so reduce the prices of products, rent would absorb all the gain; but lower costs will result in increased production by encouraging more intensive cultivation and by bringing into cultivation land which hitherto would not repay the costs of cultivation, formerly submarginal land. Thus the tractor would increase both the demand for land and the supply of available land. Whether rents would finally rise or fall is too complicated a question to be discussed here.

Technological progress and urban rents. Urban technological improvements, other than those in transportation, may have various effects on urban rents. The improvements in construction techniques which have made our modern skyscrapers possible, the use of structural steel in building, and the use of elevators, for instance, have tended to raise rents. It might seem that the effect should be quite the opposite, for these are land-saving improvements, and in agriculture such improvements tend to lower rents. People go to cities, however, because other people are there, to do business with others; and the more people are already there, the better the opportunities, within certain limits, to do business. Improvements in building techniques enable a larger population to concentrate in a given area, make it a better place to transact many kinds of business, and so tend to increase rents. There are limits to this process, of course; but the fact that our largest cities have grown faster than the smaller ones indicates that the limits may not yet be reached, even in such an urban colossus as New York City.

Such improvements in urban transportation as the automobile and bus have tended to reduce rents. When city dwellers used streetcars to go downtown, they wanted to live near a streetcar line; and since shoppers did not like to walk very far in making their purchases, the shopping district was confined to a small area in which rents were very high. The automobile and bus have greatly increased the mobility of urban populations, haye made a much wider area available for both residence and business purposes, have increased the supply of available land, and have therefore tended to reduce rents. That this is true will be clear if we try to imagine the situation if practically instantaneous and costless transportation could be provided for urban dwellers—let us say in the form of wings with which they could fly as fast as an airplane, without cost or effort. The rent on most urban residence sites would disappear almost entirely, for access to such utilities as water, gas, light, and sewer connections would be about the only reason for paying more than the land would yield for agricultural purposes. In every city the big retailing establishments tend to cluster about one or more centers fixed by streetcar or bus connections or some other factor (from Thirty-fourth to Fifty-seventh Street in New York City and the Loop in Chicago), where rents are fantastically high. If shoppers could move about without effort, the shopping district would spread over a wider area and rents would decline greatly, in some cases almost to nothing.

Not all improvements in transportation have this tendency to reduce urban business rents. Streetcars and subways, which are confined to a given route, may raise business rents in two ways. First, they increase the congestion in the business district. The fabulous rents for sites around Times Square and on Wall Street in New York City would be impossible without her unequaled system of subways. And second, such transportation facilities as these have encouraged the growth of cities, indeed have been the absolute essential to the development of large cities, and therefore of extremely high rents.

The paradox in the rise and fall of land rents

In the rise and fall of land rents, both agricultural and urban, is to be seen one of the paradoxes of economics. A rise in rents is an indication of growing scarcity, which should not be regarded as good. High rents for agricultural lands are characteristic of such overpopulated countries as Germany, Italy, and Belgium, where food costs so much that people have to skimp in their use of it, and where even farmers, as farm operators, earn only modest incomes. Low rents are characteristic of sparsely populated countries where food is plentiful and cheap and farmers earn relatively high incomes. A rise in rents, a drift toward the conditions prevailing in densely populated countries, should be regarded with little more favor than the spread of the boll weevil or corn borer, for its effects are somewhat the same. Yet, from 1896 to 1920, when both prices of farm products and rents were rising, the American people were generally happy and optimistic; whereas from 1920 to 1930, when both prices and rents were declining, they suffered not only mental anguish as they saw their land increments fade away, but actual hardship, because the economic system did not function well when land values were declining.

The American ideal: rising land values and rents

The truth is that to most Americans rising land values and rents represent about the highest economic ideal, the *summum bonum* of local and national statecraft. Doubtless here is an important reason why every American is a "booster" for his home town, his state, and his nation, why he wants them to grow, not in wisdom or culture or virtue, but in number of people. Increasing population raises land values and rents. Every town big enough to support a high school must also have a chamber of commerce whose main function apparently is to boost the town, in population. To accomplish this, it tries to secure convention meetings for the town, hoping that they will bring in new residents; to the same end, it sometimes offers free land sites and tax reductions as incentives to industrial concerns to move there. In recent years many states have set up state development commissions to bring in industries and foster industrial development within their borders, and so increase population and raise land values and rents. All these efforts are largely vain, for, like advertising, they are mutually defeated by the fact that all towns and states are in the boosting business, and each renders fruitless the efforts of the others.

In their zeal for increasing population, most Americans do not realize that this benefits only the landowners, in the long run. If the population of a town or city grows, various other classes may gain in the short run. Merchants may be able to increase their sales if there are not too many merchants among the newcomers; barbers and professional men may profit from an increase in business if there are not too many barbers and professional men among the new residents; house owners generally gain because of the larger number of people seeking homes. In the long run, however, none of these classes stand to gain appreciably, because merchants and barbers and doctors and lawyers will move there and set up business, and competition will be as keen as before. Houses will be built until their prices and rentals are brought down to the normal level that prevailed before. But with the increased population, the land, particularly business sites, will command higher rents. Only landowners gain, in the long run.

Peculiarities of rent as income

Rent is a heterogeneous income, in this respect differing somewhat from wages, and even more from interest. Rents for different tracts of land do not tend toward equality but on the contrary remain persistently different; they show every variation, from the penny or two per acre paid for the poorest grazing land to the million dollars or more paid for the most valuable sites in New York City. Wages differ much less and are not permanent in the same way, for men and women grow up, decline, and die, and other persons take their places. Interest is fairly homogeneous, for capital shifts without great friction from one place to another and from one industry to another, in response to differences in the rate of interest. Profits, as we shall see, are highly heterogeneous; but, except monopoly profits, they are generally transient and tend to disappear in the long run. Only rent is a heterogeneous and permanent income.

Rent as a surplus above cost

Rent is usually considered to be a *differential surplus above costs of production.* To the individual farmer and businessman, it is a cost like interest and wages; but from the broad social point of view, it is not a part of costs of production and it does not enter into price. There are several lines of reasoning by which this may be proved. The first argument holds that the costs of production are reckoned at the margin, where no rent is paid. The prices of products must be—perhaps we should say they *are*—high enough to cover the costs of production on marginal land; and the costs of production must be reckoned there, because if they are reckoned on superior land they will include rent, and this will involve circular reasoning—rent entering the determination of costs of production and hence of normal price, and price in turn determining rent.

A second line of argument follows from the conception of rent itself. Urban rent, for instance, measures the advantages of doing business on a given site as compared with a no-rent site—the advantages of easy access to city crowds, in the case of retailing. Theoretically, rent measures these advantages. The entrepreneur using a high-rent site cannot have higher selling costs than the one using a no-rent site, because the disadvantage of paying the high rent is just balanced by the advantage of making more sales on this site. He could never say: "My rent is high, therefore I must charge high prices," for his costs, including rent, *per unit of sales*, are no higher than those of retailers on marginal sites. Neither could a merchant on a marginal site say: "My rent is low, and therefore I can sell cheaper than the merchants in the high-rent section of the city." His rent is low; but he has fewer customers, his turnover is slower, and his unit costs, including rent, are theoretically the same as those of the merchants in the high-rent sections. "Walk around the corner and save $10 on a suit" is not a sound economic appeal—costs and prices are just as high around the corner.

A third argument for the exclusion of rent from costs of production and for the refusal to concede that it enters into price, arises from the definition of cost. To the individual farmer or urban entrepreneur, as we have already said, rent is a cost; but to society as a whole it is not a cost in the same sense that wages and interest are costs. Land is the *gifts* of nature, not the creation of man; the fertility of agricultural lands, the locations for cities, were here long before he came. It is true that he had to do much to make the land available and useful—he built roads and streets and houses and improvements of many kinds—and the interest on improvements is often difficult to distinguish from the rent on the land; but we make the distinction as well as we can, and recognize the rent as a payment for what nature provided, not a payment for sacrifices made by men. Men have to *work* to earn wages, they must *save* to earn interest; but the rent on a good farm or a well-located urban site is paid for no sacrifice. If no wages were paid labor, little work would be done, and the laborers would presumably be obliged to starve. It "costs" society the wages of labor to have work done; or we may put the costs in the form of the food, clothing, and houses that labor must consume in order to be able to work. If no interest were paid on capital, the amount of savings might be somewhat but perhaps not much less than it is. It "costs" society the interest payments to secure our present savings. On the other hand, if no rent were paid landowners,—if the state took it from them, for instance—there would be no reduction in the amount of land, for rent is not a payment for any sacrifices made in producing the land, and it cannot be eliminated. This is an important principle in taxation.

Rent as unearned income

Adam Smith looked upon landowners with a critical eye, accusing them of loving to "reap where they never sowed" but softening this with the admission that in this they are "like all other men." That he believed rent was fundamentally unearned is indicated clearly in his discussion of taxation: "Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the state, no discouragement will thereby be given to any sort of industry." Ricardo went even further, declaring that "what the landlord gains in this way [from rent], he gains at the expense of the community at large. There is no absolute gain to the society by the reproduction of rent; it is only one class profiting at the expense of another class." John Stuart Mill regarded rent as mainly or entirely unearned: "The ordinary progress of a society which increases in wealth, is at all times tending to augment the incomes of landlords; to give them both a greater amount and a greater proportion of the wealth of the community, independently of any trouble or outlay incurred by themselves. They grow richer, as it were in their sleep, without working, risking, or economizing." Still later, Henry George expressed the same idea in much the same way: "Go, get yourself a piece of ground, and hold possession. . . . You may sit down and smoke your pipe; you may lie around like the lazzaroni of Naples or the leperos of Mexico; you may go up in a balloon, or down a hole in the ground; and without doing one stroke of work, without adding one iota to the wealth of the community, in ten years you will be rich."

In the light of the drastic declines in land values and rents, from 1920 to 1939, some of these observations seem rather fantastic today, yet the general principle is fundamentally sound. We must be careful, however, in our definition of terms. For one thing, rent must be defined as a payment for what *nature* provides, not for what the owners contribute. Some of the difficulties in distinguishing land from capital, and rent from interest, have already been pointed out; but rent must often be separated also from wages, for landowners frequently do some work in connection with their land or with the capital which is used on it. They may also assume some risks and responsibilities as entrepreneurs; and if so, the rent will be mixed with profits. Thus many farm owners who do not cultivate or live on their land devote some time and energy to managing their farms, and some furnish part of the capital used in cultivation. Urban landowners similarly may own the buildings on their land and may have to attend to the renting of their property. Practically all landowners who lease their land to others have some work to do in connection with the details of the rental contract, and those who use their own land must of course manage it. When we refer to landowners we mean landowners *only in their function as owners of land;* and when we refer to rent we mean the income which remains when all other forms of income—interest, wages, and profits—have been sifted out. It is pure rent, as thus defined, that is unearned.

In what sense is rent unearned? The distinction between earned and unearned income must, however, be drawn with care. In exactly what sense is rent unearned? The farmer who, after working and saving for thirty years, buys a farm and retires to the neighboring town to live on the rent from his farm—has he not earned his rent? How does his position differ from that of the farmer who invests his savings in bonds or stocks and lives on the interest or dividends? There is no difference at all; in both cases, the farmer has earned his income. But suppose that the rent on the first man's farm doubles while he sits in his home in town and twiddles his thumbs. Well, suppose the interest or dividends on the other farmer's bonds or stocks double during the same period. There is an element of speculation in all investments, and land has probably not been a much better investment than stocks or bonds; that is, there has probably been little more unearned increment in rent than in the interest on bonds or in dividends on stocks.

But suppose a farmer homesteaded his land, paying nothing for it, and thirty years later finds himself with a substantial rent, enough to enable him to live in idleness the rest of his life; can he have earned his rent? Here also the answer is clear. Many homesteaders eventually found themselves possessed of valuable land which represented more than a fair return for their years of labor; but many others, after years of hard work and privation, found themselves the owners of land which was nearly worthless. As a rule, frontiersmen took up their land with little idea as to its productivity or the value it might finally have; some of them had to clear it of trees and brush; almost all of them had to sell their produce at very low prices, because the free land titles enticed so many into farming that farm products were always plentiful and cheap, and the frontier farmers therefore had to live very meagerly. In the hope that their land titles would some day be valuable, they worked for next to nothing for years; and the average rent increment they ultimately received was probably little or no more than fair compensation for their time and the hardships of pioneering.

It is doubtless true, similarly, that the average return to owners of urban land has not been more than their time and money would have earned in other investments. Although a few land buyers in some of our large cities have made great fortunes, there is a vastly greater number who have bought in towns that never attained metropolitan size and have lost sums which, in the aggregate, would probably equal the gains of the fortunate investors. There is scarcely a crossroads hamlet in the United States that has not been through from one to a dozen land speculation booms, and this might be said of hundreds of towns no longer on the map; in many of even the large cities can be seen streets and sidewalks running far out into the country, with a few houses scattered here and there—speculative "additions" that never panned out. Americans have always been "land value animals," much given to land speculation, but only a small proportion of them have profited from their speculation.

In what sense, then, can we say that rents are unearned? In the sense that they are *not earned by productive activity*. Consider, for instance, the pioneer who "earned" his land title and rent by living in poverty for many years, until an increased demand for farm products raised prices to the point where he could earn enough, *as a farmer*, to enjoy a fairly good life. To the extent that in the early years he produced crops and sold them, he was of course engaged productively; but the fact that those crops were very cheap in the markets indicates that his contribution to society was not much wanted. He lived mainly on his own products, a sort of Robinson Crusoe life. If men had not been lured to the frontier by the promise of land titles, they would have moved west only when they could make a reasonably good living as farmers; that is, when the prices of farm products rose high enough so that farmers could make a fairly good living producing them. Their work would have been more productive, and doubtless they would have lived better. Our pioneers wasted billions of dollars' worth of labor by pioneering too fast, in their restless search for land titles.

Urban rents, although probably earned in the sense that they are worth no more than has been invested in them, are similarly not earned by productive activity. A man who invests his money in a new business building or in a factory or in machinery helps to create new wealth; but the man who buys land does not create any more land, since land cannot be created. He only raises its price. As Carver says:

> The more men there are buying tools, machinery, buildings, etc.—for that is virtually what investment means—the greater will be the demand for such things, and the more their production will be stimulated. The normal result of this kind of investment is to increase the world's stock of tools, machinery, buildings, etc. But the more men there are buying land, but not themselves improving it, the higher the price of land goes, and that is the end of the process. No more land is produced, because land cannot be produced, and the world is no better supplied with land than it would be if men did not invest in it. Much of the investing talent of the country is perverted to this unproductive purpose.[4]

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[4] T. N. Carver, *Essays in Social Justice*, pp. 301–302. By permission of the Harvard University Press, publishers.

A good way to visualize this difference is to contrast the economic results of the business investments of Henry Ford and the Astors. By investing his savings in capital, in new plant and machinery, Ford built up the huge plants which produce millions of automobiles for the use of the people; to the extent that the Astors bought land, the Astors built nothing.

In thus indicting rent as an income gained by no productive or socially useful service, we must be careful not to suggest any moral condemnation of the recipients of rents; we are concerned only with the economic principles involved. Since society recognizes private ownership of land and private appropriation of rent as legitimate, businessmen may be expected to buy land whenever they think that it will be profitable to do so. Few of them are likely to understand the economic consequences of the business anyhow, for businessmen are generally very obtuse regarding the relation of their own activities to the general welfare, partly, perhaps, because they are not much interested in such questions. Private ownership of land is one of the rules of the capitalist game, and as Norman Thomas shrewdly observes, "Men who envy the Astors do not try to change the rules because, to paraphrase an old hymn, they 'want to be an Astor, and with the Astors stand.' "[5]

The newer conception of rent

We are now prepared to consider in greater detail the more recent concept of rent, referred to at the beginning of this chapter, as *any* surplus, in wages or interest or rent itself, above the "minimum amount necessary to keep that factor in its present occupation." According to this concept, there is in nearly all wages some surplus above what is necessary to keep laborers working at their jobs, which may be called rent. That is, if wages, instead of ranging from $3 a day to $500,000 a year, ranged only from $3 a day to $10,000 a year, we should have practically all the services that we now have, and we could tax away this surplus in wages, just as we might tax away *all* land rent, without reducing economic output. This implies that if no salaries above $10,000 were paid anywhere in the United States, the managers of our great corporations would serve for $10,000 as efficiently as they now do for much higher salaries, as would also our high-salaried movie actors and actresses, singers, surgeons, and lawyers. Lerner believes that there is much more of this type of surplus in wages than in land rent.[6]

There is much logic in this, yet there are differences between rent and other surpluses. In the first place, *all* rent is a surplus, whereas only a part of wages and interest can be so regarded. We could tax away all land rent without reducing the supply of land or of the products of land; but tax confiscation of wage surpluses, if carried far enough, would reduce the incentive to work. In the second place, the wage and interest surpluses are gained by the productive functions of working and saving, but land rents are not earned by productive functions, for landownership is not really a function. There would clearly be less equity in taking part of the income of a great surgeon than in taking the land rents of an unproductive landowner, for the surgeon at least works for his income. And finally, although taxation of wage or interest surpluses—or rents—might not reduce the amount of economic production, it would not increase it; the taxation of land rents, on the other hand, would increase economic production by forcing unproductive landowners into useful work and by reducing wasteful land speculation.

Land is different from labor and capital, and land rent is different from wage and interest surpluses. This is shown clearly by the fact that our federal government has now socialized practically all the land resources it still owns, and is steadily increasing its ownership and control. It is following this policy not as the result of any preconceived theory, but as the result of its experience in dealing with land. The government has found that the principles of free enterprise do not operate well when applied to most kinds of natural resources. This will be discussed further in the following chapter.

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[5] Norman Thomas, *America's Way Out*, p. 26.

[6] A. P. Lerner, *The Economics of Control*, p. 234.

QUESTIONS

1. In what different senses may land be productive?
2. "Land values in New York are said to be created by man—by the congestion of population there—while land values in the Kaw Valley are created by nature." Do you agree? Why or why not?
3. Distinguish between economic rent and business rent. When would they be identical?
4. "Rent is not an evidence of the bounty of nature, but rather of the niggardliness of nature." Do you agree? Why or why not? Would there be any rent if there were no law of diminishing returns? Would there be any rent if all land were equally fertile?
5. If the government confiscated all rents, what would be the effect on prices, on the intensiveness of cultivation, on the amount of rent paid by tenants, on the price of land?
6. "There are three kinds of values: those created by the owner, as in a garage that he himself builds; those created by others, as in fortunately located urban lands; and those created by nature, as in a tract of rich, undeveloped agricultural land." Criticize.
7. If the government forbade payment of rent, what would happen to rent? What would a perpetual lease without rent payment amount to? If the state owned all land, would we pay rent?
8. Is marginal corn land likely to command rent?
9. "Marginal productivity *measures* but does not *determine* rent." Explain.
10. "The market price of wheat must cover the costs of the marginal producer on marginal land." Why do we have to use "must" in this sentence?
11. Does high rent mean high costs of production? Explain. What does it measure?
12. Rent is always a surplus of what above what?
13. Argue that rent is not a cost of production from the broad social point of view.
14. "With an increase in the price of farm products there is a shift at both the extensive and intensive margins." Explain the two margins. Does either margin have anything to do with the determination of rent?
15. What is the effect of a rise of wages on rents? Of a rise in the rate of interest?
16. Rents are usually high and wages low in a densely populated country. Do the same factors that make the rents high make the wages low? Explain.
17. In analyzing the long-run price of goods, the price of labor (wages), and the price of capital (interest), we emphasized costs of production heavily. Need we do this in the problem of rent? Explain.
18. Why did the automobile depress rents in the cities? If the output of dairy cows could be doubled without increasing their feed, what would be the effect on rents?
19. "It is fortunate that scarce urban sites command a high rent." Why?
20. "Our prices are lower than those of our competitors because we do not have to pay as much rent as they do." Is this good economics? Explain. Would a tenant farmer ever make a similar statement? Discuss.
21. "Rents in retail business actually increase, not only absolutely but relatively as well, on passing from poorer to better locations, or from small to large towns." Why may this be true?
22. What do you mean by quasi-rent? In what respects is it like rent?
23. "The truth is that *high land prices are an economic and a social calamity*. They make it harder for the struggling worker to purchase land for a business, a farm, a home. They accentuate the trend toward tenancy, as against ownership by the user of the land."[7] Why then are businessmen so anxious to see land values and rents rise?
24. Can rent be said to be unearned income? Explain your answer, using any qualifications that may be necessary.
25. Suppose your home town puts on an advertising campaign and gets 10,000 more people to come to it. What economic classes will profit from the increase, in the long run? Explain why.

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[7] H. G. Brown, *The Economic Basis of Tax Reform*, p. 118.

Chapter 31.

Some Land Problems

The single tax

The idea of meeting the expenses of government through a single tax on economic rent goes back nearly two hundred years, but the plan is generally associated with the name of Henry George, who crusaded eloquently for it more than half a century ago. George went to California in 1858 at the age of eighteen, and there he saw some of the vices of a particularly vicious land system. Part of the best land was in the hands of a few grantees of the former Mexican government, and much of the rest had passed into the hands of land thieves and speculators who withheld some of it from use. In contrast to this was the growing army of landless laborers in San Francisco who were unable to secure farms and, in spite of fairly high wages, lived in poverty and insecurity. When later he went to New York for a short time, he was equally appalled by the luxury and want everywhere evident in such sharp contrast. Pondering on why poverty persisted in the midst of opulence led him to the conclusion that it was because "with the growth of population, land grows in value, and the men who work it must pay more for the privilege." A few years later, in 1879, he brought out his famous book, *Progress and Poverty*, in which he elaborated this general conclusion and formulated his proposal for a single tax on rent which was to replace all other taxes and bring greater equality of wealth and a better life for the masses. Throughout his life he preached the gospel of the single tax eloquently and untiringly and won a modest following, although he never saw his scheme adopted anywhere in the United States.[1]

Progress and poverty

Why does poverty persist in a nation of increasing wealth? That was the question Henry George set out to answer.

> Unpleasant as it may be to admit it, it is at last becoming evident that the enormous increase in productive power which has marked the present century and is still going with accelerating ratio, has no tendency to extirpate poverty or to lighten the burdens of those compelled to toil. It simply widens the gulf between Dives and Lazarus, and makes the struggle for existence more intense. The march of invention has clothed mankind with powers of which a century ago the boldest imagination could not have dreamed. But in factories where labor-saving machinery has reached its most wonderful development, little children are at work; wherever the new forces are anything like fully utilized, large classes are maintained by charity or live on the verge of recourse to it; amid the greatest accumulations of wealth, men die of starvation, and puny infants suckle dry breasts; while everywhere the greed of gain, the worship of wealth, shows the force of the fear of want. The promised land flies before us like the mirage. The fruits of the tree of knowledge turn as we grasp them to apples of Sodom that crumble at the touch.[2]

Why is this true? Malthus explained it in terms of the birth rate, but George repudiated the Malthusian doctrine as utterly unsound, and pointed to private appropriation of rent as the Mephistopheles of the tragedy. As the population grows, the increasing subdivision of labor raises its productivity, but the landowners are in a position to appropriate the gains, and in some cases even more, through increases in rents. As the population grows and rents rise, labor must pay more for the privilege of using the land, and is thus held down to a subsistence level of wages; while the landowners enjoy steadily rising incomes, not from productive labor but from the "value created by the whole community." Private appropriation of rent is thus responsible for great economic inequality, with the prizes going to non-producing landowners. "The fundamental law of nature, that her enjoyment by man shall be consequent upon his exertion, is thus violated. The one receives without producing; the others produce without receiving. The one is unjustly enriched; the others are robbed."

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[1] Arthur N. Young, *The Single Tax Movement in the United States.*

[2] *Progress and Poverty*, 10th ed., pp. 7–8.

The logical remedy for this, according to George, was to take the rent from the landowners by a tax. He thought that this tax would yield all the necessary revenues—hence the designation *single* tax—and that all other taxes could be abolished. This tax, he believed, would be simple and easy to apply; it would discourage no form of productive activity, since rent is not paid for productive effort; it would raise wages and tend to equalize incomes; and, by removing want and the fear of want, it would give free play to man's nobler, unselfish impulses. In the meantime, "with all the [tax] burdens removed which now oppress industry and hamper exchange, the production of wealth would go on with a rapidity now undreamed of."

Land rent and economic inequality

George believed that the receipt of rent by private individuals was an important cause of economic inequality, but whether he was correct is not certain. A few individuals and corporations have indeed made great unearned fortunes through the ownership of land of various kinds. In colonial times a great many of the fortunes were in the form of land, given as royal grants by the British crown or granted by the governors. Washington, perhaps the richest man of his time, owned some thousands of acres, mostly farm land; Benjamin Franklin left a fortune of around $150,000, mostly in land; Stephen Van Rensselaer owned a huge landed estate. The "big money" in land, however, came after the Revolutionary War, and mostly in the cities. Stephen Girard made most of his money in shipping and finance, but he owned large tracts of land in Philadelphia which rose rapidly in value. The Astor family, beginning with John Jacob Astor in 1789, bought New York land whose estimated total value today is 450 millions. In the same way, the Goelets piled up a fortune of some 200 millions, the Rhinelanders 100 millions, the Wendells 50 millions, and the Schermerhorns a "very considerable" fortune; and literally hundreds of other people acquired land which eventually was worth hundreds of thousands and in some cases millions. Marshall Field's fortune included 30 million dollars' worth of Chicago real estate and around 10 millions in New York and elsewhere, and Chicago real estate worth 10 millions was credited to Levi Leiter. On his death in 1863, the first Nicholas Longworth left a fortune of 15 millions, largely in Cincinnati real estate, worth much more now. The Rockefeller interests have recently invested heavily in land in New York City. Such a list as this might be extended indefinitely, for most of the billions of dollars' worth of land in the big cities is owned by someone, and its value is unearned increment that has been appropriated by the various owners since the Indians held it.[3]

The records of some plots of land in New York City read like fairy tales. One farm acquired by John Jacob Astor at a cost of $25,000 in 1800 was said to be worth 50 millions in 1929; another, bought for $20,000, increased in 120 years to a value of between 16 and 20 millions. In 1830 an impecunious young lawyer named Bixby bought a tract of land between Thirty-ninth and Fortieth streets for $200; today it is worth about 15 millions.

Landownership and the increment of value in land have created vast fortunes in other countries as well. The Earl of Derby's estate near Liverpool, England, was bought in 1724 for $35,000 and is said to be worth some $7,500,000 now. Lord Bute, owner of much of the land in Cardiff, the largest city in Wales, not long ago sold his ground rents for 100 million dollars. On this land were 20,000 houses, 250 saloons, and 1000 retail shops, among other business establishments. After the sale he owned only 117,000 acres of land, eight castles, two town houses in London and one in Edinburgh, and coal lands that net $550,000 annually in royalties. The Duke of Bedford formerly owned 250 acres in the choicest part of London and 86,000 acres outside the city, much of it granted to an ancestor by Henry VIII. Something of the nature of the landowner's "function" may be gained from the rental terms for the great Covent Garden fruit and vegetable market when it was owned by the Duke. His agents at the market levied a tax of from 1 to 5 cents on every crate, box, and barrel of fruit or vegetables sold; and this netted him about $125,000 a year, in addition to other rentals amounting to $100,000 more. All this because Henry VIII gave this land to an ancestor of the Duke a few centuries ago! The British King and other members of the royal family also hold immensely valuable lands in London and elsewhere. In England as in the United States, more and more rents are being taken by taxation, and landownership is not what it used to be.[4]

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[3] See Arthur Pound, *The Golden Earth;* and Gustavus Myers, *History of the Great American Fortunes.*

A large number of fortunes were made in this country through the acquisition of natural resources of various kinds, timber, coal, oil, iron, and range lands. Frederick Weyerhaeuser became one of the wealthiest men in the country through his ownership of timber lands, bought at very low prices or secured in other ways. The Guggenheims made much of their fortune through the ownership and exploitation of mineral lands; the Vanderbilt and Gould fortunes included some profits from the direct or indirect ownership of coal lands. Stephen B. Elkins, the "lord" of West Virginia, got his start by acquiring a Mexican land claim of nearly 2,000,000 acres in New Mexico—a claim of highly doubtful validity—and later, as Senator, by persuading Congress to legalize this claim. James J. Hill owed some of his fortune to the seizure of iron lands in Minnesota, and of copper and other mineral deposits in Montana. Henry Miller, a German immigrant boy, acquired nearly 15 million acres of land in California and Oregon, and boasted that he could drive cattle from Mexico to Canada and water them every night on his own land. Leland Stanford owned the Vina vineyard of 100,000 acres, and other ranches and great tracts in San Francisco. In the form of railroad land grants, the public lands contributed to the fortunes of many railroad capitalists. A large proportion of the big land holdings secured by individuals and corporations, throughout our westward expansion, was acquired by graft and by the corruption of local land agents, state legislatures, Congress, and federal officials.

Although private appropriation of land and the rent from land have thus created many large fortunes, the government's policy of giving settlers free homesteads distributed land values and rents widely among farmers. It is impossible to say whether the concentration of wealth would be less or greater if the government had never permitted private ownership of land. There would be no such fortunes as those of the Astors, the Wendells, and the Weyerhaeusers, but on the other hand there would not be some millions of farmers who own their own farms and enjoy modest rents from them.

The single tax a burdenless tax?

Henry George was correct in his analysis of the nature of rent, in his assumption that it is not earned by productive labor but is created by the community. His arguments for a heavy land tax are also largely sound, although the cost of government has risen so much recently that such a tax would by no means pay the entire cost, as he thought it would. The land tax would therefore have to be supplemented by other taxes, and so perhaps should not be called a "single tax"; but this does not affect the fundamental validity of the principles involved. The tax would be as easy to impose as most other taxes; it would lighten the burden of taxation on productive wealth and labor, and so would tend to encourage the formation of capital and the increase of wealth. T. N. Carver argues convincingly that, when the economic system had become adjusted to it, the tax would be practically burdenless. The corollary to this is that if the tax had been imposed at the beginning of our history, it would now yield perhaps 2 or 3 billion dollars a year and would burden no one.

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[4] Kansas City *Star*, June 23, 1938.

But suppose that the government, instead of retaining title to the land, had turned it over to private ownership but from the first had taxed away part or all of the rent. If it had taken all the rent, no one would have cared to own land unless he wished to use it. There would presumably have been no speculation in land, although if long-term leases had been granted at fixed rents there might have been speculation in leases. No one would have been burdened by the tax on rent, for no one would have been permitted to appropriate rent. Those who used land would have been as well off as they are now, for while they would have had to pay all the rent to the state, they would have paid nothing for the land. Assume, for instance, that a business site yields $4000 a year in rent and that the interest rate is 4 per cent. It would make no difference to a businessman using this site whether, under a system of private ownership, he bought it for $100,000—the capitalized value of the rent at 4 per cent—or, under the single tax, received the title free, with the obligation of paying the government $4000 a year in rent. In either case it would cost him $4000 a year to use the land.

The same principles apply when only part of the rent is taken. Suppose the government had from the beginning taken one-half the rent. To the extent that land is valued for the sake of the income it yields, it would have been worth only half as much as it was when none of the rent was taken, and the tax would have burdened no one. Investors in land would have received the same income on their investment, for they would have paid half as much for the land and would have retained only half the rent, paying the rest to the government. Active business entrepreneurs would have paid the same rent that they actually did pay and would have gained by lower taxes on their capital and business operations.

A land tax imposed from the beginning would thus be a burdenless tax in the sense that it would never burden either landowners or actual business operators, and also in the sense that it would cause no reduction in the supply of any useful good. Since land is defined as the gifts of nature and is fixed in amount, government appropriation of rent would not reduce the supply either of the land or of any of its products. In this respect a tax on land differs from a tax on man-made wealth, for the latter tax tends to reduce the supply of such wealth. Thus a tax on houses reduces the supply of houses; a tax on forests discourages the planting of trees; a tax on automobiles reduces the number of automobiles; a tax on the production of beer—to use an illustration common with economists—reduces the supply of beer.

A tax on land must be paid by landowners, and it cannot be shifted to tenants through higher rents because presumably the tenants are already paying the full economic rent to the landlord and cannot afford to pay more; nor can it be shifted to consumers of products in the form of higher prices. Such a tax does not affect the supply of or the demand for land, or the intensiveness of cultivation, or the income of tenants, or the supply of or demand for products; it only reduces the amount of rent that landowners keep for themselves.

Practical application of the single tax

A land tax was not imposed in the beginning, however, and today millions of individuals own land for which most of them have paid honestly earned money. How, without gross injustice, could the state take back this land, or assess a land tax which would amount to expropriation? Henry George favored confiscation of rent without compensation to landowners, and argued that there would be no great injustice in such a policy; but his messianic enthusiasm undoubtedly blinded him a little on this point. At any rate, it is certain that no program of outright confiscation will be adopted in this country in the predictable future. Yet land taxes have risen steadily for many years, until state governments are now taking most or all of the rent on some of the poorer land. Although legislators have generally known little or nothing about Henry George's philosophy, a few of them have unwittingly reached the single-tax goal.

Certainly nothing could be gained by state appropriation of lands or rents if the state compensated the owners of the land or the recipients of the rent. If, for instance, it took over all the land and paid the owners a fair price, it would have to borrow the money by issuing bonds, and would have to pay in interest as much as it received in rent. There would be no financial profit in such a transaction, no encouragement to productive enterprise or the creation of capital, and no discouragement of unproductive activities. The owners of the new bonds could live in idlnesss on the income of their bonds quite as well as they formerly lived on the rent they received. The government might purchase certain kinds of land for other reasons—badly eroded farm or cut-over timber lands—but it would buy them for the sake of their better protection, not to reduce parasitism or waste of human energy.

The land tax in future tax systems

If confiscation of land or rent is ethically indefensible, and if state appropriation with fair compensation offers no important advantages, what point is there to any discussion of the single tax? Of what significance is it to conclude that it would have been well if the government had adopted such a policy from the beginning, since the government did not do so? The logical answer might seem to be that it is of no significance, but this is not correct. The principles we have elaborated are of practical importance today in various ways. In the first place, many authorities on taxation maintain that while it is too late for the state to appropriate past "unearned increments" in land, it should provide for the capture of future increments. It might assess the land today, and provide for the appropriation of future increases in value. This is very difficult to do, because the present value of land is to some extent determined by the chance of future increase in value; but as far as possible, the government should take future increments.

In the second place, since a tax on land, or rent, has definite advantages over taxes on capital or productive enterprise, the state should move in the general direction of heavier land taxes whenever it is necessary to increase revenues. Any new tax, any change in the tax system, involves some injustice because it imposes a burden which the people have not included in their calculations. Even so, when the state and federal governments change their tax systems, as they frequently do, they might well consider the relatively less burdensome land tax. If injustice must be done, let it be done in the furtherance of an intelligent general policy. It is no more unjust to raise taxes on land than to raise taxes on capital, and the long-run effects, as we have seen, are less harmful.

Public ownership of natural resources

National parks. The single-tax movement has never gained much public support in the United States, but within the past half century or more the federal government and some state governments have moved steadily toward public ownership of natural resources. This policy was first applied to scenic lands when the Yellowstone National Park was established, in 1872, as a national playground for the people. Since that time, twenty-two other such parks have been created and are visited by several million people each year. The general purpose behind their creation is the preservation of their scenic beauty, flowers, and wildlife, and the forestalling of private claims within these areas. There is a fundamental incongruity in the private monopolization of the great scenic wonders created by nature, and private holdings have often interfered with the proper administration of the parks, as in the case of the Yosemite National Park. At one time a private mining company owned the only trail down into the Grand Canyon, and so much of the shore of beautiful Lake Tahoe is owned privately today that tourists driving around the lake see mostly the garbage pails and ash cans in the back yards of the private homes. With increasing use and enjoyment of our national parks, the wisdom of the policy of public reservation becomes more evident each year. Our national park system is rather unique, although a few countries have copied it to some extent. Canada has several national parks of great scenic beauty, managed in somewhat the same way as our own. Many of our states have also established state parks, covering areas of modest scenic or historical interest, to serve as recreation areas for the people.

National forests. The creation of national forests dates from 1891, when Congress authorized the President to set aside forested areas on the public domain, to be owned and administered by the federal government as national forests. Under the provisions of this law, a total of some 165,000,000 acres have been set aside for this purpose. Although these are mainly in the western states, there are small areas in the Appalachian and White Mountains which the government is enlarging as rapidly as funds are made available. It is the plan of the United States Forest Service eventually to buy up much of the Appalachian Mountain area, much of the region around the Great Lakes, and certain rough and eroded sections in various parts of the country, and restore them all to forest uses. Some of our states have likewise been building up state forests, and a few cities have developed municipal forests that are also used as parks.

In almost all advanced countries the central government has found it necessary to take over at least part of the nation's timber lands and to regulate cutting on privately owned forests. Unregulated private ownership has been tried in various countries, as in the United States, and generally with disastrous results. China probably affords the most tragic lesson in forest management. The private owners of forest lands on the upper watersheds of her rivers have for generations been permitted to cut timber without restriction; and today many of these forests are gone, and every rain washes vast quantities of top soil or subsoil down into the rivers, which deposit this as silt farther downstream. Consequently, not only is much of the timber gone, but much of China's richest farm land is subject to devastating floods which sometimes cost millions of lives. China today represents the terrible end toward which the United States is drifting, to some extent because of private ownership of our forest lands and the wasteful methods of lumbering which are often employed. This culmination would be much nearer if our government did not own some of our forest lands.

But private ownership does not necessarily result in devastation if the cutting of timber is carefully regulated by the government and adequate requirements are made for reforestation. Some of the forests in Sweden, Finland, and Germany are owned privately, but the governments regulate cutting very carefully, and there is no such devastation as much of our own privately owned timber lands show. The history of forest exploitation—often called "development" by Americans—indicates that conservation can best be insured by government ownership of the land and strict regulation of timber cutting on private lands.

Why cannot private owners afford to cut timber conservatively and make proper provision for reforestation? Why do they cut and slash, clear the lands as quickly as possible, and then move on to others to repeat the process? The answer is to be found largely in the great cost of holding standing timber—the taxes, fire prevention, and, even more important, the interest charges on the heavy investment required. With interest compounded at 6 per cent—the rate which private owners often have to pay—and with even a modest tax rate and expense for fire protection, standing timber would have to double in value about every ten years to make its preservation profitable, and the value seldom increases so fast. The result is that private owners are obliged to cut their timber rapidly and recklessly. For the same reason that they cannot afford to hold standing timber long, they cannot afford to reforest cut-over land. In the time required for most trees to grow to maturity, even a comparatively low reforestation cost would mount up, at compound interest, to a sum greater than the owners could realize in the market. The government has two advantages over private individuals in the ownership of timber: it can hold it at a lower rate of interest, and therefore at an investment figure which does not rise so rapidly, and it is not restricted to purely profit considerations. It can afford to hold timber even at a loss, for the protection of mountain watersheds or for any other good purpose.

Desert lands and range lands. Somewhat the same considerations that led to the creation of our national parks and forests have led the government to retain title to most of our desert lands and the poorer grades of grazing lands. Most desert lands are worthless, but if, as sometimes happens, minerals are discovered on them, it is well for the government to be in a position to regulate their exploitation. On millions of acres of grazing lands in the West, the grass serves not only as forage for cattle and sheep but as a protective cover for the land. The latter is often the more important of the two, for destruction of this grass cover leads to erosion and to the deposit of silt in the impounding reservoirs used in irrigation. The history of our western range lands proves that private ownership often leads to overgrazing and grave injury to the grass cover, to which the public must not be indifferent.

Congress in 1934 passed the Taylor Grazing Control Act, which authorized the federal government to withdraw from private entry 80,000,000 acres of range lands as a federal grazing reserve. All our remaining public land should have been thus reserved, and the Taylor Act represents only a good start toward the intelligent administration of such lands.

Mineral reserves. The reservation policy has also been applied to various mineral resources. As a result, the federal government in 1936 owned 30,000,000 acres of coal lands that contain more than 200,000,000,000 tons of coal; 500,000 acres of phosphate lands that can supply 8,000,000,000 tons of fertilizer; 65 developed oil and gas fields with an annual production of 33,000,000 barrels of oil; 4,000,000 acres of oil shale land, from which approximately 60,000,000,000 barrels of oil can be extracted when oil prices are high enough to warrant the cost; and an undetermined acreage of potash deposits.

Irrigated lands. Irrigated lands need not be owned by the government, but the trend here, as with most kinds of land, has been toward more and more government intervention and control. For many years irrigation was regarded as a private function, and a great deal of land was irrigated by private companies. Later the states were granted public land on condition that they irrigate it, but little was done by the states. Finally, in 1902, the federal government entered the field and under the Reclamation Act has built a considerable number of irrigation projects, some of them, like Boulder Dam and Grand Coulee, of vast magnitude. Although these projects have not been profitable and in some cases have even cost the government a heavy net expense, there is no reason to believe that the federal government will abandon its irrigation work. On the contrary, it is probable that it will do much of the work that is done in the future.

Swamp lands. The history of swamp land drainage has followed that of irrigation in many respects. At first, drainage was left to private enterprise. Later some millions of acres of swamp lands were turned over to the states for drainage, but the states did little with these lands; and in recent years the federal government has assumed more and more responsibility in the work of drainage.

Water power. The federal government controls navigable rivers, and therefore the development of water power on such rivers; but private operators have developed many projects on smaller rivers. The water power on the public domain in the West originally belonged to the federal government, but private interests acquired many valuable sites before the government, during Theodore Roosevelt's administration, reserved all the sites that were left. This policy was the result of the persistent work of Gifford Pinchot, who devoted his life largely to the cause of conservation. In recent years the federal government has built a number of tremendous hydroelectric plants, among the best known of which are Boulder Dam, Grand Coulee Dam—the latter the largest in the world and reputed to be the greatest structure, by cubic content, ever erected by man—Bonneville Dam, and the chain of dams in the Tennessee Valley. Such great projects may provide not only power but water for irrigation, and in some parts of the country they aid in the control of floods. In the production of power they of course serve to conserve the fuel that would otherwise have to be used in engines; and further development is to be hoped for. Only about one-fourth of our potential water power has been developed.

To the extent that it has been applied, government ownership of natural resources represents a fine democratic movement. No unearned fortunes have been made on government-owned lands. All the increment in the national parks, forests, and mineral reserves goes to the people as a whole and not to a few fortunate individuals. The advantages of this may be seen in Wyoming, where the state owns much of the oil lands and leases them to private operators. Here the oil royalties, which under private ownership would go to build a few millionaires' homes, are used for building roads and schools and for other purposes that benefit all the people in the state. If the government of the United States had from the beginning retained title to all our subsoil mineral deposits, as some other countries have done, our wealth would be more equally distributed and our economic and political institutions would be on a higher plane.

Although this policy may seem radical, it is the land policy of our federal government today. The government no longer sells lands but keeps them in the public domain; moreover, it is buying up some kinds of land—forests, for instance—as rapidly as funds are available. It is true that the government shut the barn door only after most of the horses were stolen, but now the door is tight latched.

The record of private enterprise in land use

In the utilization and exploitation of natural resources, except farm lands, private enterprise has on the whole done a sorry job. Adam Smith thought that under laissez-faire capitalism anyone who sought his own private gain was led by an "invisible hand" to do well for society generally; and for many kinds of economic activity he was correct. The merchant, seeking his own gain, must operate a good store and render a useful public service if he is to prosper; the doctor, the dentist, the baker, the candlestick maker likewise do well for the public, generally, in seeking private gain. In the exploitation of natural resources, however, there is no such identity of individual and public advantage. We have already seen that landowners do no useful service for the rent they receive. Oil men have often made fortunes while wasting much of the irreplaceable oil produced, and all the natural gas; lumbermen have piled up fortunes in wasteful operations which left barren tracts behind them; coal operators have sometimes made profits precisely because they were willing to waste much of the coal whose conservation would have cost them money. Farmers, in their quest for profits in a generally unprofitable industry, have wasted and in some cases ruined farm land that was steep and easily eroded; and city real estate men have sought profits in badly planned suburban developments which meant the permanent disfigurement of the sections involved. Private enterprise in the ownership, use, and exploitation of most natural resources has not been justified by its results. One of the tasks facing our government during the next century will be to repair the ravages resulting from three centuries of waste and spoliation under private enterprise.

The vital need for an integrated land-use plan

Government ownership or control of natural resources, except ordinary farm lands, is superior not only because it guards against waste more effectively, but because the government can better coordinate the various uses of land and the appropriate measures needed for its protection. Private owners who waste their land may do grave injury to others, perhaps hundreds of miles away. Thus if the rancher in Montana overgrazes his land, the soil may wash into the Missouri River, and from it into the Mississippi, to be deposited as silt in the bed of the stream, increasing floods throughout the length of the river and perhaps interfering with navigation.

All the various uses of land can be regulated only by federal action. They should be coordinated throughout the country to give the optimum benefit to the largest number of people for the longest possible time. This means *planning*, over-all planning, by the federal government; it means conservation of forests, range lands, scenic areas, farm lands, and subsoil minerals; it means the building of dams, the development of irrigation projects and of parks and other recreational facilities, the protection of streams, lakes, and ocean beaches from pollution, the protection and propagation of some forms of wildlife, including fish, and the limitation or eradication of certain other injurious forms and of many kinds of insects. Most of these functions must be carried on by the federal government on a nation-wide scale; and some of them, as for instance the protection of migratory wild fowl, call for international cooperation.

The problem of farm lands

Ordinary farm lands present a somewhat different problem, for such lands are owned privately in most countries, except Russia. Apparently many people have a strong "land hunger," a hunger that in some cases seems almost an instinct; hence private ownership of farm lands may be a wise policy because, or as long as, it satisfies this hunger. However, the ownership of such land is gradually passing from the operators to absentee owners, banks, and mortgage and insurance companies; almost every decade has shown a decline in the percentage of owner-operated farms. If this shift of ownership proceeds to the point where, as in England, most of our farm lands are owned by absentee owners, with landless tenants doing the farming, the case for private ownership will no longer be very strong.

Tenancy

The kind of tenancy that is developing in the United States is hardly consistent with our democratic ideals, and is socially harmful in various ways. Many tenants move every two or three years, and therefore they take little interest in maintaining soil fertility or in developing a healthy social life in the community. In a community of tenant farmers there can be little of that pride of ownership which builds up good homes and attractive farmsteads. Although conditions of tenancy vary greatly in different sections of the country, on the whole they are not such that we can view them with any complacence.

There are three different ways of attacking the tenancy problem. We might, in the first place, recognize it as inevitable and try to make the conditions as tolerable as possible. This would involve the dictation of leases which would guard against waste of either land or improvements, would encourage tenants to make improvements by indemnifying them, in case they moved, for all they had made, and would, in general, encourage terms fair to both tenant and landowner. This is the policy followed by the British government for many years; but of course conditions of life are much more stable in England than in this country. It is not uncommon for one farm to remain in the hands of the same tenant family for generations.

A second method of attack would be recognize tenancy as inevitable but to make the state the landowner. Whether the state would be able to arrange better terms of tenancy than private owners is a question which cannot be answered dogmatically; but state ownership is so contrary to American traditions that it is unlikely to be tried, except perhaps in the case of grazing lands and certain other marginal and submarginal land. The federal government might well buy up the land now being cultivated in the Dust Bowl of Kansas, Colorado, Oklahoma, and Texas, allow it to regain a grass cover, and then lease it to cattle men, with careful restrictions to prevent overgrazing. Leasing such land would of course be far simpler than leasing farms in Iowa and Illinois.

A third line of attack would be to recognize tenancy as a serious threat to American democracy and reduce it to the minimum. This might be done in several ways. The government might lend money to tenants at a low rate of interest to enable them to purchase land. This has been done in several European countries and is being done in the United States, although the rate of interest, 4 to 4.5 per cent, is too high to be very effective.

More effective than such loans would be government restrictions on absentee ownership. The government might, for instance, forbid any but farm operators to buy farm land, and require all other owners to sell their farms within a certain period of time; or it might impose particularly heavy taxes on farm land owned by non-farmers. By thus restricting landownership to farm operators, the government could keep the price of land down to where tenants could afford to buy and could make their payments from the returns on the land. One of the important reasons why tenants cannot buy land is that the price is too high; it is kept high partly by the purchases of absentee buyers who are satisfied with a lower rate of return than the tenant must have if he is to make his payments. If, for example, land yields a rent of $5 per acre, a tenant can barely afford to pay $100 for it unless he can pay all or most of the purchase price at once. But the absentee banker or lawyer, with money to invest, can afford to invest for a 2 per cent return, for that is as much as government bonds yield. This means that he can afford to pay $250 for this land, for $5 rent per acre will yield 2 per cent on that price, and thus he can bid the land away from the tenant, whose interest rate is about 5 per cent. This is one cause of the rise in tenancy. The absentee bankers, lawyers, and businessmen who invest in farms represent "scab" competition in the land market, somewhat as their wives and daughters do in the labor market. Just as such women can afford to work for less than self-supporting women must have, so these town and city men, and also the farmers who own other land, can afford to pay a price that yields a lower net income than the tenant buyer must have if he is to make his payments.[5]

The problem of large landed estates

Any plan for keeping farm lands in the hands of farm operators might well incorporate a reasonable limitation on the size of farms, the size varying, of course, with the type of agriculture. Many countries lack the fundamental basis of democratic government to some extent because of the prevalence of great landed estates owned by men who constitute a sort of feudal aristocracy. This was once true of Mexico, although the present government is trying to break up the large holdings and parcel them out in small farms; it is true in many countries of South America, and is one of the reasons why some of them find it difficult to maintain a democratic government; before the war it was true in parts of Prussia, where large landowners made up much of the nobility and the backbone of German militarism; and it is true in England, where a landed nobility with great estates maintains some of the traditions of feudalism and offers a fairly united front against advances in political and economic democracy. The United States has presented a fairly democratic situation in the ownership of farm lands, but conditions are changing for, as we have seen, in some of the fruit-producing sections of the West the one-family fruit ranches are being displaced by big corporate ranches cultivated by armies of propertyless and migratory laborers. Such a situation cannot serve as the basis of a genuinely democratic government or of genuinely free enterprise. Even if one-family farms are less efficient than large corporate ranches, they should be maintained. Some things are more important than efficiency, and democracy is one of them.

The decline of agriculture

The increase in tenancy is only one aspect of the generally declining status of farmers in the United States, and indeed in many other countries of the world, since 1920. Before 1920, American farmers as a class were generally fairly hopeful and prosperous. Their incomes were modest and in some cases rather meager, but they enjoyed greater economic security than most other classes, and rising land values helped them to build up small fortunes. Although there were periods of recession and hardship, such as the years between 1873 and 1896, farmers on the whole constituted a self-reliant and moderately prosperous middle class far different from the European peasant farmers. From 1896 to the onset of the First World War in 1914, farm incomes and land values rose rapidly; and during the war and until 1920 farmers enjoyed unprecedented prosperity and land values climbed to fantastic levels. There was a rather widespread belief that farming was destined to be a bonanza for the indefinite future.

Then suddenly, in the later months of 1920, prices of farm products started a precipitous decline from which there was no genuine revival until the outbreak of the Second World War twenty years later. American industry revived in 1922 and rolled along with increasing momentum until 1929, but farmers shared little in this prosperity as producers, and land values continued their steady decline. The crisis of 1929 hit both industry and agriculture, and neither staged a substantial and sustained recovery until the beginning of the Second World War. From 1921 to 1940, agriculture remained in the doldrums, prices of farm products were at almost the lowest level in our history, farm land prices sagged persistently, and farms fell by the thousand to mortgage holders or were sold for taxes. For a few years farmers looked forward hopefully to the possibility of recovery; but it finally became clear that there might be no genuine recovery, that agriculture was down for the count. The era of rising agricultural prosperity was apparently at an end, with no definite promise of revival. It seemed that American farmers were falling to the peasant status which has been that of most farmers throughout history, everywhere in the world.

Not all classes of farmers suffered equally or in the same way, although few were able to maintain their living standards entirely unchanged. Southern sharecroppers had always lived miserably, in many cases below the level of European peasants, but their situation grew even worse, whereas the dairymen in Wisconsin and Minnesota and some farmers in New England and other eastern states maintained their standard of living without very drastic changes. The worst sufferers were probably the wheat and cotton farmers and some of the small fruit growers in the West.

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[5] See University of Illinois Agricultural Experiment Station, *Bulletin 502*, for an excellent discussion of this problem.

What were the causes of this rapid decline and persistent depression in agriculture? To some extent it was connected with the general economic depression after 1929; but the agricultural recession had begun in 1920, eight years earlier, and farmers had gained little during industry's seven fat years from 1922 to 1929, while they suffered heavily in the general economic distress that followed. The industrial paralysis of 1929 to 1939 affected agriculture in two ways. In the first place, unemployed laborers and bankrupt businessmen could not provide a good market for farm products. What was commonly regarded as agricultural overproduction was largely underconsumption resulting from lack of purchasing power. In the second place, the industrial stagnation and unemployment in our cities stopped the exodus of men and women from the farms, where with the shift to power farming they were no longer needed. In fact, during some of these years there was a reverse migration back to the farms. It has been estimated that in 1939 there were some 10,000,000 more people on farms than were needed to produce that year's agricultural output. Between 1940 and 1944, however, more than 5,000,000 persons 14 years old and over left the farms.

While the general economic depression intensified the distress, it was not the only cause of it, for there were other factors which affected agriculture in particular. The development of the internal combustion engine in trucks, automobiles, and tractors played an important part. Tractor farming tended to increase overproduction by increasing the amount of land that farmers could cultivate, by enabling them to farm land which could not be profitably cultivated with horses, and by releasing for the production of human food millions of acres that had formerly produced the feed for the horses that furnished the power. Trucks and automobiles took the place of horse-drawn vehicles and so reduced the demand for feed. Since in some measure this was happening in many other parts of the world too, the foreign demand for American farm products tended to decline.

This reduction in the foreign demand for our farm crops, particularly for wheat and cotton, was a second factor in the undermining of our agricultural prosperity. During much of the period following the Civil War, the United States was the world's great exporter of cotton and grain; but a few decades ago other countries—Canada, Australia, Argentina, India, and Russia—began to claim more and more of this trade. This competition was not disastrous prior to the First World War, and of course during that war there was need for all that could be produced; but soon after the end of the war American farm producers found stiff competition in the markets of Europe.

During this time too, notably after 1918, many of the great food-importing nations of Europe were striving to attain self-sufficiency in their food requirements by various means, particularly by tariffs on food imports. Such barriers to our export markets would have been less serious if the United States, shortly before the outbreak of World War I, had not severely curtailed immigration. Had immigrants continued to crowd into this country and to settle in cities, they would have increased the domestic market for farm products and thus compensated for the loss of our foreign markets. Our restriction of immigration was a wise and beneficial policy, but it did tend to reduce the price of farm products.

It was not foreign tariffs alone that curtailed the export markets for our farm products. Our own tariff policy has had the same effect. Our high duties, imposed largely for the benefit of our manufacturing industries, have reduced exports and lowered the prices of some of our great export crops, such as cotton, wheat, and fruits, while at the same time they raised the prices of some manufactured products that farmers have to buy.

In considering the prices of farm products, we must remember that the demand for most food products is rather inelastic—highly so for some of them, as for instance wheat—and that therefore a small increase in the supply may reduce prices considerably. Low prices of most farm products do not necessarily indicate very great overproduction.

Another reason for the decline of agriculture has been suggested in the chapters on price. As we saw there, agriculture is an almost purely competitive business, whereas urban industries are all more or less monopolized. Farmers have little or no control over the prices of their products, and their horizontal average revenue curve gives them no incentive to restrict production, even in times of depression and low prices. They have a heavy investment in land and machinery which yield no return if not used, and most of them do much or all of their own work and cannot shift easily to other kinds of work. Since they can get no better price for a reduced output, they tend to maintain production at a fairly steady level. Farmers are the only economic class that produce about all they can, in good years and bad, and dump it onto the market for what it will bring. So in our economy this highly competitive, individually operated business of agriculture is pitted against the highly organized, integrated, and more or less monopolized corporate urban industries; and of course agriculture fares badly.

How much the farmers' economic condition declined after the First World War is indicated by a comparison of per capita income in urban states and agricultural states for 1919 and 1939.

Per Capita Income[6]

	1919	1939
Urban states		
Connecticut	$717	$768
Delaware	792	848
New York	874	825
Rhode Island	720	666
Massachusetts	788	705
Agricultural states		
Nebraska	702	421
North Dakota	515	362
Kansas	602	411
Iowa	706	446
Mississippi	351	203

Americans often boast of their high plane of living, but most of our farmers do not live very comfortably. Only 33 per cent have electricity in their homes (this figure was 15 per cent before the Rural Electrification Service began its work), only 27 per cent have kitchen sinks and drains, only 17 per cent have cold water and only 8 per cent have hot water piped into the house, only 9 per cent have flush toilets, and only 8 per cent have furnace heat. A considerable proportion of our farm population usually has an inadequate and badly balanced diet; and in educational, dental, and medical facilities farmers are generally at a serious disadvantage as compared with town and city people.

World War II brought farm prices up to highly profitable levels which have persisted since; but it is doubtful if they can be maintained for many years without some form of government support.

QUESTIONS

1. What are some of the evils in the private appropriation of rents? In what ways is it wasteful of human energy?
2. How would a heavy land tax affect the wages of farm labor, the wages of management of farm operators, the intensiveness of cultivation, the rents that tenants pay, the amount of farm improvements made, the supply of farm products, the number of retired farm owners?
3. What advantages does a heavy land tax have over a tax on incomes or capital?
4. Is there any more justice in taking a man's land rent from him if he has paid for the land, than in taking his bonds or stocks? Would it not be unjust to expropriate land without compensating the owners, and unprofitable to pay them what the land is worth? If so, what is the point of talking about a single tax?
5. A heavy progressive income tax is in some respects like a heavy land tax. Explain.
6. Why should all natural resources, except ordinary farm land, be owned by the government? What advantages has the government over private individuals in owning such resources?

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[6] The 1919 figures are from Oswald W. Knauth, *Distribution of Income by States in 1919;* the 1939 figures are from John L. Martin's study in *Survey of Current Business,* October, 1940.

7. Why is it important that forest lands be protected with particular care? Why do the federal, state, and local governments do more and more to provide recreational facilities for the people? Can we not trust private enterprise to do this?
8. The percentage of tenant-operated farms has declined slightly in the last ten years. Is this decline likely to continue? Why worry about tenancy? In what three ways could the problem be attacked?
9. In 1940 the farm population constituted about 25 per cent of our total population but received less than 9 per cent of our national income. Why do farmers fare badly as compared with city people? What remedies would you suggest for the depressed state of agriculture?

Chapter 32.

Profits

Profits defined

There are many concepts and definitions of profits, but we shall define this term as *the returns accruing to the entrepreneur for his services (1) in managing a business enterprise and (2) in assuming the risks inherent in a dynamic, changing economy.* The entrepreneur, as Taussig has said, "stands at the helm of industry and guides its operations." He is the one who furnishes the "steam," the driving power, in a capitalist society; he is the one who applies that power in the direction which promises the greatest profits to him. He controls the accelerator and the steering wheel. Lured by the chance of gain, he hires the labor, borrows the capital, and rents the land; or if he has his own capital and land, he allows himself "imputed" interest and rent on them. If his business operations yield him a surplus above the amount needed to pay for these factors of production, that surplus is his profit. Profit in this sense thus includes the two elements of wages of management and *pure* profits, if any, the latter representing the *surplus above wages of management.*

The concept of profits as including wages of management and pure profits, if any, calls for some explanation. Clearly profits must cover wages of management in the long run, because wages of management, including the reward due for risk taking, which is one of the functions of management, are a cost of production as truly as ordinary wages, interest, or rent. If, for example, the price of butter is not high enough to cover the wages of management of dairymen, some men will leave the field and go into the production of something else, the supply of butter will be reduced, and the price will rise again to a point where it will cover costs, including wages of management.

In a competitive business, however, price cannot remain above cost of production in the long run, and therefore the entrepreneur can earn nothing above wages of management. In short, he must get wages of management, and he can get no more than that. Are not profits and wages of management therefore identical? The answer is in the affirmative. But why then have we defined profits as including pure profits? Because there are some pure profits in the short run under competitive conditions, and there are vast monopoly profits, pure profits, which may persist indefinitely. Even in the most purely competitive industry—farming—entrepreneurs sometimes make pure profits, something above wages of management, through changes in market prices. Such pure profits cannot last, however. Monopoly profits may last in the long run because there is no freedom of entry into monopolized industries.

Another reason for including pure profits in our concept of profits is that it is very difficult to draw a distinction between wages of management and pure profits, difficult to tell how much of an entrepreneur's income is due to his ability as a manager and how much is due to other factors. In the long run, all should be regarded as wages of management; for if he earns a high income consistently through many years, it is evident that he is an able man and that the income measures the value of his services as manager. Yet he does sometimes receive pure profits, and therefore we can include them in our concept.

Profits the reward for management and risk taking

Management and risk taking are the two functions of the profit maker. Neither alone is sufficient. One who merely manages is a laborer of a high order; to be sure he runs the risk of losing his job if he does not manage well, but every laborer faces the same risk. Risk taking alone is not enough either. Anyone who leaps out of a second-story window or plays catch with sticks of dynamite assumes a risk, but he does not for that reason earn profits. The risks must be taken in connection with the management of a business enterprise; furthermore, they must be of a non-insurable character, for if they are insurable they cease to be necessary risks.

Management functions of the entrepreneur

The management functions of the entrepreneur are almost infinitely varied. He must, for example, appraise the risks of the undertaking with judgment; this requires a prophetic eye, a long view, and the ability to see future opportunities for profits. When the opportunities for profit in a given venture are clearly realized by the average, unimaginative entrepreneur, they are no longer very great. Furthermore, if the entrepreneur is to avoid losses, he must be able to see any difficulties ahead and give them due weight; for unreasoning and unwarranted enthusiasm, the inability to foresee possible difficulties and expenses, have been the cause of unnumbered failures in business. Having chosen the field he will enter, the entrepreneur must manage his business well, which means that he must make countless decisions as wisely as possible. He must employ the most profitable combination not only of land, labor, and capital, but of the various *units* of these factors. A clothing merchant, for instance, should have not only the best combination of land, labor, and capital, but the right relative investment in the various items in his equipment and stock, the right number and type of employees, neither too expensive nor too cheap for his kind of business. He must choose his staff with an understanding of human nature, and must get the best out of them by using the right relative amounts of compulsion and encouragement.

By "right amounts" of each of the factors of production, we mean the relative amounts which will yield the maximum profits. There is a conceivable adjustment of all the factors used in a business which will yield maximum profits, an adjustment which would be secured by using each factor up to the point where its marginal productivity equals its price. The size of the business and the amount of all the factors used will of course depend finally on the ability of the entrepreneur.

Management and the development of new methods

Profits are sometimes assumed to be the reward for the development of new methods, new inventions, and new industries; but we may well include these under the general function of management, for it is one of the tasks of good management to move ahead and constantly improve ways of doing things. Profits are often earned by striking out on new paths, by improving upon traditional methods. Woolworth made his profits by developing a chain of stores in which low prices and rapid turnover were emphasized. Carnegie was one of the important figures in the development of the steel industry. Before the formation of the United States Steel Corporation he was usually several jumps ahead of most of his competitors in his technological methods, and was therefore in a position to demand the lion's share of the profits made in the creation of that great monopoly. Henry Ford, something of an inventor himself, made much of his vast fortune by keeping technologically ahead of his competitors, by advancing mass production to a stage hitherto unknown; but he lost much of his leadership and some of his fortune when he went to sleep on his Model T car while the Chevrolet car was being improved. George Westinghouse made a large fortune as an inventor and businessman, and founded the business which bears his name; Thomas Edison earned a considerable fortune in the same way.

Profits and risk

Ours is a dynamic and changing economy. Industries grow up and perhaps decline or shift from one region to another; government policies change unpredictably from year to year, bringing new opportunities for profits in some industries and losses in others—a factor that is assuming growing importance because the government is intervening more in business. Natural resources and raw materials are exhausted in certain regions and new supplies are found in other sections—consider illustrations in the lumber and oil and gas industries; new methods of transportation bring geographical shifts of population and industry—such as came from the development of the automobile, bus, and truck; consumer tastes and demands change with kaleidoscopic rapidity—consider the effects of the change to short skirts on the relative demands for woolen cloth, silk hose, and depilatories; price levels move up and down mercurially, transferring billions in wealth and income from one class to another. There is much evidence of increasing changefulness in our economy, with increasing risks to be borne by the entrepreneurial class in those industries which are still severely competitive. In such a changeable economy, if goods are to be produced, someone must assume the risks, and here appears perhaps the second characteristic function of the entrepreneur, the function by which pure profits, if any, are earned.

Are there on the whole any net pure profits?

As already suggested, pure profits are characteristic of the short run in a competitive situation; they appear here and there with the changes in a dynamic economy, but they tend to disappear in the long run. Now the assumption of risks necessarily means that there is a chance to lose, perhaps heavily—that is, to make less than wages of management—as well as a chance to make something above wages of management, pure profits. Whether pure profits outweigh the losses is a question which cannot be answered dogmatically. According to Taussig, they do; but Frank Knight questions this. Simon Kuznets estimates that from the period 1879–1888 to 1938 capital formation grew in volume at a cumulative rate of about 3.1 per cent per year, which was scarcely enough to cover compound interest at the prevailing rate and left nothing for pure profits.[1] These figures are for the economy as a whole, including the monopolized portion; and if we assume that monopolized industries generally make profits, we must conclude that competitive businesses yield net losses. It is impossible to be very definite about this, however, and we may well reserve final judgment.

Resemblance of profits to other income

In some of their various aspects, profits resemble certain other income, particularly wages and rent. To the extent that they are the reward of competent management, they resemble wages rather closely. Like wages, they depend in large measure on productivity, and again like wages, they vary with the importance of the work done. In some kinds of work men move from the wage-earning class to entrepreneurship and back again, some of them rather frequently, as for instance carpenters who undertake a construction job occasionally but work at their trade the rest of the time, and clothing salesmen who work for wages a few years, then set up a little shop of their own, and return again to wage labor if the venture fails or if they become discouraged. In farming, and in some of the smaller retailing lines, the entrepreneur does not earn a labor income much above that of the laborers he hires, if he hires any.

The resemblance of profits to rent has often been noted. The ability to manage and to assume risks successfully is largely a natural gift, scarce like land and highly heterogeneous like land. Like a well-located business site or a very fertile farm, the exceptional ability of a capable entrepreneur is very productive; or, to put this another way, just as labor and capital are more productive if employed on good land, so they are more productive if managed by an able entrepreneur. Rents would be low if there were a large amount of the best land, and profits similarly would be low if there were a large number of the ablest entrepreneurs. They would also be low if business geniuses could be developed from ordinary college students by means of suitable training in business. If this were possible, business incomes would tend toward equality and would be just high enough to cover costs of production, that is, to give compensation for the time, energy, and money spent in training. Business ability of the highest order, however, seems to be largely inherited, largely a gift of nature, like land; and its income cannot be greatly affected by the competition of college-trained men of ordinary abilities. The *Fortune* study of business managers indicates that big corporations often secure fairly able men from the colleges, that the colleges "can be counted on to supply lieutenants and captains, but few colonels and generals."[2] Costs of production have little more effect here than they do on the value of Wall Street business sites.

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[1] Simon Kuznets, *Capital Formation, 1879–1938*, University of Pennsylvania Bicentennial Conference.

The profits of businessmen present greater differentials than the incomes of professional men. There are of course great differences in the incomes of doctors, lawyers, dentists, engineers, and accountants, differences that correspond roughly with ability and industry. A few doctors and lawyers have accumulated a million dollars or more. According to gossip, Charles Evans Hughes at one time earned a million dollars a year as a lawyer in New York, and the Kansas goat gland specialist, Dr. John Brinkley, was once reported by newspapers as receiving an income, presumably gross, of a million dollars a year; while, on the other hand, there are many other lawyers and doctors who are barely able to make a living. Yet business incomes vary even more. No professional man has ever built up a fortune approaching that of Ford, Rockefeller, Astor, or Morgan; and the lowest business incomes are probably on the average less than those of the least successful professional men. The incomes of teachers and preachers vary least of all; but this may be not because abilities vary less in these fields than in the other professions and in business, but because teachers and preachers are presumed to be little interested in making money, as indeed they must be if they are to be happy.

Profits as residual income

Profits are often referred to as residual income—what is left after wages, interest, and rent are subtracted, the rate of these three being determined by the principle of demand and supply. This view is sound for the short run. In the long run, however, pure profits tend to disappear, so that only the wages of management remain; and wages of management are not residual in this sense, for even in the long run they must be paid, just like wages, interest, and rent, if business is to be carried on. They are included in the costs of production.

Profits in corporate business

The concept of profits is usually discussed in connection with the individual entrepreneurship, and this seems to be necessary, for profits are difficult to single out in a corporation. What are ordinarily referred to as the profits of a corporation include interest, and sometimes other elements as well.

Earned vs. unearned profits

The profit motive, the itch for gain, is the driving force behind economic activity, but it does not necessarily impel men to engage in socially productive activities. To the extent that they are permitted, men may seek profits in socially unproductive activities; and profits have often been unearned, in one sense or another.

It is difficult, however, to distinguish between earned and unearned profits. In the first place, no precise meaning can be ascribed to the terms earned and unearned. In one sense, earned profits may be thought of as due to hard work, and unearned profits as due to inherited ability. In another sense, earned profits may be said to include those secured by providing goods or services that the public *wants*, whereas unearned profits are made by doing things that the public does not want done, such as robbing corporations from the inside. In still another sense, the distinction may hinge on whether the goods or services provided are good for people or not—good books vs. marijuana or hair tonic. In yet another sense, it may turn on whether the entrepreneur's activities are good for the public generally or promote only his own interests. Finally, the distinction may depend on whether profits are due to the entrepreneur's abilities and efforts or to luck or circumstances.

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[2] *Fortune*, February, 1940, pp. 58 ff.

In the second place, it is difficult to distinguish clearly between earned and unearned profits because profits are often partly earned, in one sense or another, and partly unearned. Andrew Carnegie made his fortune partly by producing steel efficiently, partly by grinding the very life out of thousands of laborers, partly by charging the exorbitant prices for steel which the protective tariff permitted, partly by being lucky, partly by bargaining shrewdly with J. P. Morgan when the United States Steel Corporation was formed, and partly through monopoly. Rockefeller's fortune was made by efficient management, on the one hand, and, on the other, by practically every unfair and monopolistic practice known. Railroad promoters built the transcontinental railroads or saw to it that someone else did, but some of them made their millions by looting the railroads and the people scandalously. Many lumbermen achieved their wealth by stealing much of their timber holdings, ruthlessly destroying the timber, and leaving a barren waste behind them; but they did provide cheap lumber for consumers for a while.

Taking as an example the distinction between profits earned by socially useful production and those gained through no useful service, and applying the principle of relativity, we find every shading, not merely from profits which are entirely earned to those which are entirely unearned, but from those which are *more than earned* to those which are *more than unearned,* that is, from those which represent only a part of the entrepreneur's entire useful contribution to those which are gained by inflicting injury on the public. The Woolworth fortune might be considered representative of the first extreme, for it represents only a small fraction of the social contribution made by Woolworth in developing mass marketing of inexpensive goods. Similarly, for every dollar of profits that Edison earned, the public undoubtedly received many dollars' worth of benefit in various forms. Those who regard the automobile as the greatest good in life will probably say that Ford's fortune represents only a fraction of the total joy he contributed to American life. On the other hand, many fortunes have been piled up by the manufacturers of useless or positively injurious cosmetics and patent medicines, by businessmen who have corrupted city, state, and national governments, and by others who have imposed a loss on society greater than the amount of their gains. Between these two extremes are various shadings from pure earning to pure stealing.

Granting the impossibility of drawing clear and precise distinctions between earned and unearned profits, we shall do the best we can. The profits discussed early in this chapter are assumed to be earned, earned by management and risk taking; and we turn now to unearned profits.

Sources of unearned profits

Monopoly. The most important source of unearned profits is monopoly. The following records of profits, selected from monographs of the Temporary National Economic Committee, mostly from Clair Wilcox's monograph, "Competition and Monopoly in American Industry," give a good picture of the green pastures in which some monopolies have been foraging.[8]

From 1896 to 1906, Standard Oil's average "net income ranged between 48.8 per cent and 84.5 per cent of the cost of its properties, with annual average of 61 per cent."

"From 1890 to 1904, American Tobacco's annual return never fell below 41 per cent of the value of its tangible assets; in the years 1895 to 1900 it ranged from 16 per cent to 31 per cent; in the years 1901 to 1908, it varied from 30 per cent to 37 per cent. The average annual profit during these 19 years was 34.5 per cent."

The Aluminum Company of America: "In the 50 years from the time of its incorporation in 1888 up to 1939 its total net income was in excess of $335,000,000. In the 24 years from 1889 through 1912 it made $33,000,000 on an original investment of $2,000,000. Its average annual return on invested capital stood at 35.7 per cent from 1905 to 1908, at 17.6 per cent from 1909 to 1914, at 19.3 per cent from 1915 to 1918."

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[8] *Monograph No. 21; Monograph No. 28,* p. 99. The word profits is not used in these records in the sense in which we are using it. Some of the figures include what would be called interest in strictly economic terminology, and others represent returns above wages of management. They indicate clearly enough, however, the extraordinary earnings of some monopolies.

The Hartford-Empire Company (glassware): "From 1912 through 1937 the average annual return on its investment was 9.99 per cent. It made 16.64 per cent in 1934, 23.59 per cent in 1935, 48.24 per cent in 1936, and 67.77 per cent in 1937." Pittsburgh Plate Glass made 27.8 per cent in 1923, and 17.1 per cent in 1937. Libby-Owens-Ford made from 10 to 28 per cent on net worth between 1933 and 1938.

The Climax Company, which controlls molybdenum, made no profits between 1918 and 1932. "In that year [1932] it realized 3.12 per cent on its invested capital; in 1933 it made 14.42 per cent, and in 1934, 26.45 per cent. In 1935 the company added a 'discovered increment' of $70,500,000 to its appraisal of its ore deposits, raising the valuation of its invested capital from $7,500,000 to $78,000,000. On the new basis of valuation it realized 7.65 per cent in 1935, 6.65 per cent in 1936, 9.10 per cent in 1937, 9.97 per cent in 1938, and 13.13 per cent in 1939. On the former basis of valuation its profit would have appeared to be 10 times as large, rising from 76.5 per cent in 1935 to 131.3 per cent in 1939."

Western Electric Company, in fifty-five years, made "a net income on cash paid—in capital that exceeded 20 per cent in 41 years, 50 per cent in 25 years, and 100 per cent in 6 years."

Fifteen of the major pipe-line companies enjoyed an average return of 28.4 per cent in 1938.

The Westinghouse Air Brake Company, starting with $500,000 capitalization in 1869, by 1923 increased it to $50,000,000 entirely out of earnings, at the same time paying a good dividend rate to its stockholders; in 1937 it earned 13.7 per cent on its net worth.

The Freeport Sulphur Company earned an average profit of 13.3 per cent from 1919 to 1938 and, over a period of twenty-five years, an average return of 24.75 per cent on the ledger value of its stock. The Texas Gulf Company, also a producer of sulphur, has done even better: "Over a period of 18 years, its dividends, on the basis of the original value of its stock, have amounted to 95.46 per cent per year."

Two of our great radio broadcasting systems, National and Columbia, enjoyed returns of 80 per cent and 71 per cent respectively on tangible property in 1938.

The American Viscose Company, with a total initial investment of $930,000, "earned" total net profits of $354,000,000 in twenty-four years, or more than 38000 per cent on the original investment.

Milk distribution monopolies have had little trouble with the proverbial wolf at the door. From 1929 to 1934, a period of deep depression, ten large processors and distributors realized an average return of 10.25 per cent on their stockholders' investment; and even in 1933, when the depression was at its worst, some companies made from 12 to 25 per cent.

Public utilities are popularly supposed to be regulated and their earnings limited to a reasonable return on the actual investment; but regulation has often been more or less of a farce, and earnings have sometimes been very high. The American Telephone and Telegraph Company has an impressive record of earnings. It "realized 18.4 per cent on the par value of its capital stock and paid an annual cash dividend averaging more than $15 on each $100 share thereof during the years from 1881 to 1899, declared a 100 per cent dividend in stock in 1900, realized 11.44 per cent on its doubled capitalization during the years from 1900 to 1929, . . . and had accumulated an undistributed surplus of $400,000,000 by the end of 1931 which enabled it to maintain its $9 dividend without interruption throughout the great depression."

Many other public utilities, despite alleged regulation, have done well.

A legislative commission, examining 75 electrical utilities in New York State in 1928, found 56 of them realizing more than 8 per cent on the depreciated value of their capital investment, 34 of them more than 10 per cent, 15 more than 15 per cent, 10 more than 20 per cent, and 1 more than 30 per cent. Another legislative committee, examining 53 gas and electric companies in Pennsylvania in 1929, found 40 of them realizing more than the legal 7 per cent on their own valuation of their own property, 18 of them more than 14 per cent, 11 more than 21 per cent, 6 more than 28 per cent, 4 more than 35 per cent, and 1 of them nearly 70 per cent, 10 times the fair rate of return. The Federal Trade Commission, examining 36 gas and electric companies in various parts of the United States, found 22 of them realizing more than 25 per cent on actual investment in some year between 1922 and 1931, 17 of them more than 33 per cent, 12 more than 50 per cent, 1 of them 128 per cent, a second 278 per cent, and a third 435 per cent. A few holding companies, siphoning off operating company revenues and pyramiding their dividends through the holding company structure, did even better during the 1920's, obtaining rates of return that reached well-nigh astronomical proportions.

The profits of some of the insurance companies, which to some extent are monopolized, have likewise been princely. "The original paid-in capital of the 25 now largest stock companies was $9,242,720. At the end of 1938 these companies had declared dividends totaling $173,563,434 and had accumulated a surplus of $137,913,582."

Not all monopolies make large profits, and some are operated at a loss. Many of the railroads, which at one time were highly profitable, have in recent years earned little or nothing on their common stock and some not much on their bonded indebtedness, partly, in some cases, because they have at some time been looted from the inside, but mostly because of the business depression and the competition of automobiles, trucks, and busses. Many street railway systems, similarly profitable at one time, found their profits vanishing when automobiles came into general use. The average revenue and cost curves of a monopoly may be such that there is no price at which it can earn enough even to cover costs.

Luck. A second source of unearned profits is luck. As we have seen, one of the functions of entrepreneurs is the assumption of risks, and where there are risks there will inevitably be some good luck and some bad luck. Some entrepreneurs will have more than their share of good luck, and others more than their share of the bad; but if on the whole they have sized up the risks accurately, the bad luck should balance the good, and there will be no general gain from good luck. By assuming the risks, the entrepreneurs as a class have earned whatever they secure through good luck. Luck, however, may bring individual entrepreneurs profits out of all proportion to their abilities, and in this sense profits may be regarded as unearned. In a long life in business the good and bad luck will tend to balance; yet in some cases a streak of one or the other may make the difference between success and at least partial failure.

Some men stress luck as very important in business success, whereas others, including most successful businessmen, believe that only superior business talent and tireless application can avail in the long run. Julius Rosenwald, formerly president of Sears, Roebuck & Company, once won refrigeration space in the hearts of his business contemporaries by declaring that it does not require extraordinary brains to make money, that success is due 95 per cent to luck and 5 per cent to ability. He said that any number of men in his employ could run his business as well as he could, but credited his own high position and huge fortune to the fact that he had got the "breaks."

In a few instances of business success, luck is doubtless the most important element. The history of gold mining contains many stories of lucky prospectors who made fortunes, some running into the millions, by the merest chance; and this is true also of oil drilling. Some of the lucky discoverers of rich resources received only a small part of the total gain, and some lost all that they gained, because they lacked the judgment to manage the business that grew out of it, or to invest their profits safely. To make consistent profits in an enterprise, an entrepreneur usually must be continuously lucky or competent, and he cannot well depend on the former.

Although luck sometimes plays a less important part, it is always an element in profits. The broad swings of business activity from one field to another inevitably make for unearned profits in some industries and unearned losses in others. In the rapid development of our railroads and shipping before the Civil War, profits were made by many who had the luck to be in those industries; similarly, in the decline of our shipping after that war, and of our railroads in more recent years, many competent men who had the bad luck to be connected with those industries suffered heavy losses. Carnegie and Rockefeller happened to be leaders in industries that were *bound to develop* rapidly during the period following the Civil War; and their profits, as well as those of hundreds of other men in these industries, were in part due to this element of luck. To some extent, these men had entered such industries because they were sagacious enough to foresee their coming growth, but to some extent unquestionably, they *happened* to be riding the rising tide.

The same may be said of the great profits sometimes made in the huge centers of wealth, as contrasted with the modest profits made in smaller places. Some of our ablest and most ambitious young men go to the big cities, but it is inconceivable that all of them do. Some of those who go make large profits, whereas few who remain in the small towns or on farms can earn very much. The ablest businessman in Lawrence, Kansas—a town of 15,000—made two or three millions while Carnegie, in Pennsylvania, was making more than 300 millions. Carnegie may have been the abler of the two, although the writer doubts it. Certainly the two fortunes measure not merely the difference between the abilities of the two men but, in part at least, the differences in the circumstances under which they worked. Doubtless there are some men of great business ability on farms, but it would take a business Napoleon to make as much as a million dollars on a farm, even if he had continuous and boundless good luck.

From still another angle it is clear that great profits are due in part to luck or circumstances. Let us suppose the United States to be still in the simple economy of colonial days, almost entirely agricultural, with no large cities, with little trade among the various parts of the country, and therefore with each community largely isolated and self-sufficient. In such an economy, how much could the ablest entrepreneur earn? Washington was reputed to be the richest man in the country when conditions were like this, and he was worth perhaps half a million dollars. Now let us picture the United States as she is today, largely urban, with great cities, with railroads and highways binding the different sections of the country together in an integrated economy, and with a vast amount of trade among the various parts. Obviously the change to an integrated economy brings many opportunities for amassing huge fortunes out of profits. The fortunes of all our multimillionaires are thus in part, perhaps largely, due to circumstances for which they can claim no credit. As we have already seen, one of the worst effects of our present highly integrated capitalist system is its tendency to create differences in income out of all proportion to differences in ability.

The business cycle. Vast unearned profits or unearned losses accrue to lucky or unlucky businessmen because of changes in business conditions and in the price level. Men who happen to enter business at the bottom of a depression and who build or buy their plants, machinery, and raw materials at depression prices are in a good position to make profits as business improves and prices rise. They may be able to establish themselves so firmly during the prosperity phase of the cycle that they can stand the impact of an ensuing depression without distress if they do not have excessive inventories of goods on hand or heavy outstanding debts.

On the other hand, entrepreneurs who undertake business ventures at or near the peak of the prosperity phase, who build or buy their plants and machinery and raw materials at high prices, are almost certain to lose, particularly if they incur debts. Many of the young men who went out into the rosy world of business and farming during and immediately after the prosperous years of the First World War lost all they had in the decline of 1921.

It may be argued, to be sure, that the men who choose the best time to engage in business are shrewd, and that their profits are the result of shrewd risk taking. This is true in some cases, but in many cases the element of luck is most important, for few men can see very far into the future.[4] Shrewd businessmen are generally rather cautious and do not ordinarily get into a position where a severe depression will ruin them; but all this means is that they will lose less than they would if they were less cautious. They lose in a depression and they profit during prosperity, however cautious they are.

There are many illustrations of the importance of this sort of luck in the building of great fortunes. Carnegie entered the iron business just before the Civil War, and the rise in the price of axles from 2 to 12 cents a pound made his business highly profitable. He might have lost his modest fortune during the depression that followed the war had he not happened to make a fortunate speculation in Pennsylvania oil lands which netted him a million dollars. Henry Ford bought out all the stockholders in his company just before the depression of 1921, contracting to pay some $77,000,000. With the onset of the depression he found himself in a highly precarious position, and managed to scrape together the money he owed only by making the most highhanded demands on his agents. Had he been only a little more heavily involved, he might have lost most of his fortune and wound up his career with a few million dollars instead of a few hundred million.

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[4] For a humorous demonstration of the inability of leading businessmen to foresee business conditions, see Edward Angly, *Oh Yeah?* The predictions of our business leaders from 1928 to 1931 were almost uniformly wrong.

Consumer exploitation. Profits are often gained partly by exploitation of consumers through the sale of goods at unreasonably high prices, or the sale of inferior goods. It is particularly difficult to define exploitation accurately, because, as is true of most economic definitions, it is a question of more or less; but certainly there is a great deal of consumer exploitation in the business world. The sale of one-fifth of a cent's worth of germicide for a dollar is strongly suggestive of exploitation; the sale of five cents' worth of tooth paste for fifty cents suggests that some manufacturer has merely reversed the old Rotarian saw to read: "He serves best who profits most"; the sale of identical mattresses at widely varying prices may be only a way of allowing some people to establish their social position by paying a high price for something that they could as well buy more cheaply.

The exploitation of labor. A fifth source of unearned profits is the exploitation of labor. In a very simple economy this would be relatively unimportant because the laborers could meet their employers on fairly equal terms. Even today, farmers are usually not able to exploit their hired hands to any serious extent. But where entrepreneurs employ thousands of laborers—particularly if, as in the steel industry, the men are largely foreign and ignorant of the English language—the laborers, unless well organized, are nearly helpless to protect their interests and have often been exploited with little mercy. Carnegie, and later the United States Steel Corporation, are horrible examples.

Changes in consumer demand. Changes in demand often result in profits or losses for lucky or unlucky entrepreneurs. Those, for instance, who happened to be in the optical business during the past two or three decades, or engaged in the manufacture of cigarettes, cement, aluminumware, or plumbing supplies, have enjoyed a rising demand for their products; whereas those who operate railroads and street railways, and the producers of wheat, cotton, wagons and buggies, harnesses, and fine jewelry have faced a declining demand and consequently declining or vanishing profits. The increased use of automobiles in recent years has led to a serious decrease in the demand for shoes. Published reports about the use of injurious amounts of lead and arsenic on apples, some of them doubtless exaggerated, caused serious losses to many apple growers. When petroleum was first discovered in Pennsylvania, it was marketed in barrels and the cooperage business was highly profitable; but when pipe lines were built, the coopers' trade ran into evil days. Some producers are able to shift into other, perhaps allied, lines of production when the demand changes; but in some cases this is difficult or impossible, and heavy losses result.

Population shifts. Large profits, and less frequently heavy losses, may accrue from the growth, decline, or shift in the population. In the long run, as we have seen, the gains from an increase in population go largely or entirely to landowners; but in the short run, or as long as the population is growing, businessmen generally make higher profits than they could if it were stationary or declining. Since the population of most of our large cities has usually increased, this has clearly been a rather common source of unearned profits.

Government policies. Another source of unearned profits is often inherent in the relation of business to the government, in the outright corruption of the government by businessmen, or in the advantages that may accrue to some businesses, without any taint of impropriety, from changes in government policy. Corruption and bribery have been rather common in our history. In our land policy, for instance, frauds were so common as to arouse little comment. Thus, as early as 1795, a group of swindlers bribed the Georgia legislature to sell them several million acres of land for a few cents per acre. Laws which were seldom strictly or honestly applied enabled lumber operators to steal millions of acres of timber land in the South and West and in the Lake states; in fact, it would be no exaggeration to say that in some of our richest timber areas nearly all the land that was obtained was stolen because there was no legal way of securing title to it. Grazing lands, oil lands, coal lands, mineral lands, and water-power sites were often taken fraudulently, in many cases through bribery of government officials and at very small cost. This was the source of many of the fortunes made in the West.

Government grants of land to the transcontinental railroads were partly responsible for the great fortunes of such men as Collis Huntington, Charles Crocker, Leland Stanford, and Mark Hopkins—the "Pacific Quartette," as they were sometimes called. Government subsidies to shipping and aircraft companies have made many princely fortunes, a part of which were certainly not earned. The shipping subsidies were supposed to be given for carrying mail, to encourage the development of our merchant marine; but they contributed more to the profits of the various companies, or perhaps only their officers, than to the building up of a merchant marine. The president of one shipping company received $971,660 in salary and commissions and dividends in 1928; and the president of another received commissions amounting to $698,750 for purchasing ships from the government at low prices. Considerable graft has usually been connected with such subsidies. One aircraft company was reported to have "earned" $11,437,250 in seven years, on an investment of $1000, by selling airplanes to the government and carrying mail. Part of the fortunes amassed by Astor, Vanderbilt, Gould, and many other wealthy financiers represented profits resulting from corruption of the government, federal, state, or municipal. The oil magnates who bribed government officials in the famous Teapot Dome scandal expected to make several hundred millions out of the rape of the naval oil reserves, and they very nearly succeeded.

Corruption in most of our large municipal governments has brought vast profits to certain men. Through much of our history, city administrations have been dominated by corrupt machines which mercilessly exploited the people. Tammany Hall, the New York City machine, began its long career of corruption as early as 1800. Boss Tweed and his gang built a county courthouse worth $250,000, at a cost to the taxpayers of $8,000,000, listing chairs at $470 each, and safes for the storage of valuable papers at $400,000 each. Tweed was sent to prison, but Tammany was back in power within a few years and has, until recently, dominated the city's politics much of the time since. Most of our cities have had their own Tammany Halls, under other names, which have made millions in profits.

The relation of business to government does not always involve corruption, but government policies in the economic field inevitably have some influence on profits. Prohibition was ruinous to brewers and distillers and correspondingly beneficial to bootleggers; the building of the Panama Canal poured unearned profits into the coffers of shipping companies and subjected the transcontinental railroads to unmerited losses; the building of a large navy raises profits in the shipbuilding and steel industries; air mail subsidies increase the profits in the aircraft business and reduce them in the telegraph and telephone industry. The rapid expansion of government activities in recent years has made this type of unearned profits increasingly important.

Two government policies that have an influence in this respect have to do with the tariff and taxation. The tariff is partly responsible for many of our great fortunes; Carnegie, for instance, is said to have made an annual profit of 100 per cent for several years by charging exorbitant prices for steel under the protection of our high tariff; the railroads, on the other hand, suffered a reduction in their profits because of the high prices they had to pay for steel rails. Any change in the tariff, either upward or downward, is likely to bring unearned profits to some and unearned losses to others. Any change in our taxation policies is likely to have the same effect. Thus an increase in the excise tax on tobacco or beer tends to lower the profits of those industries.

War. War always throws huge unearned bounties into the laps of some businessmen, but it may levy a heavy toll on others. A major war brings great unearned prosperity to the manufacturers of such war materials as steel, copper, chemicals, and munitions, whereas producers of non-essentials suffer losses; and the inflation which accompanies war brings losses to creditors through the depreciation in the value of money, while debtors gain.

The record of the munition makers—the "hucksters of death"—is a ghoulish story of cold-blooded murder for profit. These buzzards, operating in several countries and many of them closely connected through stock ownership and otherwise, hire propagandists to work against the success of peace conferences. The Bethlehem Steel Corporation sent a lobbyist to at least one of the European peace conferences presumably for this purpose. During the First World War the munition makers were so strong that European governments issued special orders to protect their plants from bombardment, and there is some evidence that they manipulated government policies to prolong the war. Armament makers in Germany and in other countries as well furnished much of the money used to finance Hitler's political campaign; the Comité des Forges, the association of the big French armament makers, is said to have contributed generously to his campaign funds, presumably with the knowledge that his success would mean another war and more profits. While millions of soldiers were being slaughtered in Flanders and Galicia during World War I, the munition makers—the Krupps and Schneiders and Thyssens and Zarahoffs—were piling up hundreds of millions in profits. A nation at war must of course have munitions and other war supplies, and the purveyors of these goods thus earn part of their generally high profits; but in stirring up international friction, in fomenting and prolonging wars—as there is some evidence that the European munition makers did during the First World War—and in selling to both sides impartially, they can hardly be said to have earned their profits.

Other sources. There are many other sources of unearned profits. One of the most fruitful is undoubtedly found in the various kinds of manipulation practiced by corporation officers which have already been discussed.[5] Some men have made large profits by going through bankruptcy, in some cases several times, each time defrauding their creditors and saving something for themselves. The "receivership racket" has also created some good-sized fortunes for lawyers and others on the inside. When Samuel Insull's utility system collapsed, a total of $405,300 was paid to the receivers and their lawyers, and receivership fees of almost $800,000—nearly half the company's assets—were claimed when the American Bond and Mortgage Company went bankrupt. Not infrequently the receivers themselves take whatever can be salvaged from the business. Profits running into millions have been made in the reorganization of bankrupt railroads. A "great" newspaper owner in the West made millions, largely through learning of scandals in the lives of wealthy people and demanding "hush money" for silence—blackmail, in other words—and the same man was reported to have received $350,000 in cash for changing his paper's policy regarding the introduction of natural gas into his city, one of the largest in the West. The stand taken by newspapers on public utilities, labor problems, and various other economic questions may be very important in determining public opinion; and some papers have made large unearned profits by adjusting their editorial policies to the requirements of those who are willing to buy public support. Commercial bribery is doubtless more common than most people realize, and more so than it used to be. The purchasing agent of a corporation, for instance, choosing among different brands of a given article or commodity needed by his firm, may find that a gift of a few thousand dollars from one of the salesmen helps him make a suitable choice. In the stock and grain and cotton markets, various shady manipulations have often been the means of making vast unearned profits for operators who know the ropes. Jay Gould's profit of some $11,000,000, made by cornering the gold market on "Black Friday" in 1869, is a classical illustration; scores of others, less dramatic, might be mentioned. One stock market operator in New York was said to have paid nearly $300,000 in bribes to financial writers to puff certain stocks that he wanted to unload on the public. But the iniquities of the stock market are too numerous to discuss here; moreover, they are less serious today than they used to be.

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[5] See chap. 8.

Earned profits again

Our long list of unearned profits might make it appear that most pure profits, if we include monopoly profits, are unearned; and indeed most great fortunes are in part unearned, perhaps in several senses, particularly in the sense that they are gained to some extent by monopoly. On the other hand, however, there are millions of manufacturers, merchants, farmers, bankers, contractors, and other entrepreneurs, in enterprises which are effectively competitive, whose modest profits are earned mainly by productive services, by hard work and strict attention to business. To complete our picture of unearned profits, we may well concede too that some laborers and labor leaders receive incomes which are partly unearned. We might include also some doctors and lawyers and politicians and bureaucrats and dentists and engineers and accountants and singers, and, quite possibly, even a few professors. It is not to be expected that earnings will everywhere be exactly proportioned to productive services.

The incomes of farmers are perhaps more generally earned than those of any other economic class, partly because farmers sell in an almost purely competitive market, on the sellers' side, and partly because farming offers so few opportunities for making money by unproductive activities. No farmer has ever found a salesmanship technique that would extract a single pound of extra product from an acre of land, a dairy herd, or a lot of beef cattle or hogs. Hard work and intelligent management are about the only means of making even modest profits in farming.

It is one of the tasks of government to eliminate unearned profits as far as possible, to reduce to a minimum the waste involved in unproductive and predatory activities. Accordingly our Congress has passed legislation against monopoly, gambling, racketeering, misrepresentation, adulteration of goods, oppression of labor, manipulation of markets, and a hundred other unproductive activities. This legislative record is impressive, and there can be no doubt that in competitive fields of business enterprise the opportunities for gaining unearned profits are not what they used to be. Moreover, standards of business and professional ethics are much higher today than they were a generation or two ago. The greatest sources of unearned profits that still remain in business are monopoly and corporation management in general. Although the government has been able to put a stop to some of the abuses in the latter, irresponsible control of "other people's money" still offers many opportunities for unearned profits.

Profits as a cause of the decline of capitalism

Profits have been given a sinister significance in our economy by socialists and other critics of capitalism. In the chapter on business cycles we considered the charge that it is the extraction of profits from the stream of social income, and the failure of entrepreneurs to invest their profits, which make it impossible for the masses of the people to buy all the goods produced, and so result in periodic breakdowns of our capitalist system. Something like this was the conclusion of the Brookings Foundation, although the Brookings Foundation did not single out profits from the other income received by the rich.

Some radical economists find in profits the fatal cancer of capitalism. If business is to proceed, entrepreneurs must have confidence that they will be able to make profits; but in the more or less monopolized industries profits depend on scarcity, and with the immense productivity of modern industry scarcity can be maintained only by keeping a great many laborers in idleness. Strachey goes further and says: "A direct attempt to produce plenty without a change in the ownership of the means of production [socialism] wrecks itself at once, since it takes no account of the fact that plenty will destroy profits, and that profits, so long as the means of production are privately owned, are a necessary condition for any production at all."[6]

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[6] John Strachey, *The Nature of Capitalist Crisis*, p. 102.

Qualities of successful businessmen

Much has been written about the qualities necessary to business success. Some idealists have been sharply critical. Thus John Ruskin, always bitterly hostile to the business civilization that was growing up in England, appraised successful businessmen as follows: "In a community regulated by laws of demand and supply, but protected from open violence, the persons who become rich are, generally speaking, industrious, resolute, proud, covetous, prompt, methodical, sensible, unimaginative, insensitive, and ignorant."

Although economics is far removed from his special field, Albert Einstein once defined a successful businessman as "mostly one who receives from his neighbors far more than his services to them justifies." Even more critical of the profit makers was Charles Francis Adams, himself a very wealthy railroad executive but at the same time a man of scholarly interests: "Indeed, as I approach the end, I am more than a little puzzled to account for the instances I have seen of business success—money-getting. It comes from a rather low instinct. Certainly, so far as my observation goes, it is rarely met with in connection with the finer or more interesting traits of character. I have known, and known tolerably well, a good many 'successful' men—'big' financially—men famous during the last half-century; and a less interesting crowd I do not care to encounter. Not one that I have known would I care to meet again, either in this world or the next; nor is one of them associated in my mind with the idea of humor, thought or refinement. A set of mere money getters and traders, they were essentially unattractive and uninteresting."[7] Bertrand Russell believes that there is no reason to assume that financial success has anything to do with intellectual superiority.

On the other hand, Francis A. Walker, America's leading economist a generation ago, regarded profits as due mainly to exceptional abilities and classified businessmen into grades solely on the basis of ability. His highest grade included "those rarely-gifted persons who, in common phrase, seem to turn every thing they touch into gold; whose commercial dealings have the air of magic; who have such insight as almost to seem to have foresight; who are so resolute and firm in temper that apprehension and alarms and repeated shocks of disaster never cause them to relax their hold or change their course; who have such command over men that all with whom they have to do acquire vigor from the contact and work for them as they would not, perhaps could not, work for others"—entrepreneurial Tarzans, presumably. In the next class below these were the men "of a high order of talent, though without genius or any thing savoring of magic, whose unqualified success is easily comprehended, even if it can not be imitated: men of natural mastery, sagacious, prompt and resolute." Below this are the "men who enjoy a harmonious union of all the qualities of the entrepreneur, though only in moderate degree"; and below this, the multitude of men "commonly in business because they have forced themselves into it under a mistaken idea of their own abilities."[8]

It is easy to generalize too freely about the qualities of successful entrepreneurs. As Marshall says: "The abilities required to make an ideal employer are so great and so numerous that very few persons can exhibit them all in a very high degree. Their relative importance however varies with the nature of the industry and the size of the business; and while one employer excels in one set of qualities, another excels in another; scarcely any two owe their success to exactly the same combination of advantages. Some men make their way by the use of none but noble qualities, while others owe their prosperity to qualities in which there is very little that is really admirable except sagacity and strength of purpose."[9] Taussig likewise insists that "too much stress must not be laid on any enumeration of the business man's qualities. . . . The variety among the men who prove to have the money-making capacity is a standing cause of wonder."[10] Yet Taussig suggests imagination, judgment, courage, and administrative capacity as essential to great business success. He believes further that surprises are more common in business than in any other walk of life; that the qualities which make for success not infrequently develop late, or at any rate show themselves late, and only under actual trial. Henry Ford, who did not begin to achieve success until he was forty years old, is a good example of this.

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[7] Charles Francis Adams, *An Autobiography*, p. 190. By permission of Houghton Mifflin Company, publishers.

[8] Francis A. Walker, *Political Economy*, 3rd ed., pp. 238–239.

[9] Alfred Marshall, *Principles of Economics*, p. 298.

[10] F. W. Taussig, *Principles of Economics*, 4th ed., vol. ii, pp. 169–173.

Development of business leaders

As far as home environment and training are concerned, it is clear that most business leaders come from business families. Taussig and Joslyn found that few come from families of laborers, that an increasing proportion of them have college training, and that about one-fourth have relatives who gave them their first position—"pull" is apparently of some importance. The *Fortune* study already referred to found that, of the presidents of 100 large corporations, 54 had gone to college, 32 were self-made in the fullest sense of the word, 12 had inherited their positions, and only 9 had been office boys.[11] These proportions probably represent a change from those prevailing a generation or two ago. Probably the proportion of college men has increased, very likely the proportion of self-made men has declined, and there is some reason to believe that the proportion of men who achieve their positions through family connections has risen.

Formal business training. The extent to which entrepreneurial ability can be developed by specialized training is a question about which there is some difference of opinion. The past few decades have seen the rapid development of business schools of various kinds, first in business colleges and later in high schools and universities. College training in business began in the Wharton School of Finance and Economy at the University of Pennsylvania in 1881; today almost all our universities and many of our colleges have schools of business with a total enrollment of nearly 100,000 students.

Business training in the United States, as elsewhere, does not have as its main objective the development of entrepreneurs. As big business comes to dominate the economic field more and more, there are fewer and fewer opportunities for business leaders, and greater ability is needed by those who manage the large enterprises. Since most students are only moderately able, it would be futile to try to train all of them for such important positions; therefore business schools are devoted partly or mainly to training accountants, statisticians, salesmen, and other specialists, and to broadening their students' outlook through the study of economics and the other social sciences.

Business ability of the highest order, like almost all kinds of genius, has seldom owed much to formal education; and it is not likely that college training in business would have been of much direct benefit to such leaders as Carnegie, Rockefeller, and Vanderbilt. Indeed it might have reduced their power to earn and accumulate money by enlarging their intellectual interests and reducing their interest in money.

There are some reasons for believing, however, that a business education may develop entrepreneurial ability in moderately able young men. A knowledge of such tool subjects as accounting and statistics is useful in any business. An understanding of the principles of economics, particularly such subjects as money and banking and business cycles, may enable a businessman to understand broad economic trends, avoid heavy losses in a crisis, or take advantage of a rising tide of prosperity. Some understanding of labor problems should enable him to get along with his employees more harmoniously than most businessmen do. Businessmen sometimes lose heavily as a result of strikes and labor trouble that they could avoid if they understood labor psychology better. Indeed a college education often proves useful in many ways, directly and indirectly; and as the amount of systematic knowledge of business increases, a college education will become more and more essential. Whether, as some predict, business will ever become a profession in the sense that medicine and law are professions may well be doubted, for business is assumed to be based on the profit motive, whereas the professions are assumed to be based in part on other motives, such as the desire to render a public service. Nevertheless, business will no doubt tend toward the professional ideal. Such fields as accounting have already attained something approximately professional status.

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[11] *Fortune*, February, 1940, pp. 58 ff.

Business education is usually not of such a character as to bring out the students' best talents. Some of the work is of no great importance; in some cases it represents merely facts which are collected and loaded into the students' minds "as goods are loaded into trucks." Marshall believed that the aim of business training should be to develop power rather than knowledge, an aim which is ignored in many courses commonly offered. His criticism of such training in England applies also to that in the United States: "A great part of the instruction, given in most schools and many universities, imparts information, with scarcely any education in the true sense of the term: much of it even tends to hinder the movements of faculty by clogging it with inert matter. For indeed a man, whose own mind is stagnant, can impart knowledge without effort: but the education of faculty is a task which calls for vitality and initiative on the part of the educator."[12]

There is good reason to believe that the best education, in business as in any other vocation, is competently supervised training in doing the things that the student expects to do later. Thus the business student should be trained to solve the type of problems that he will face later as a businessman. The development of this type of education may be seen in our law schools in the past few decades. At one time law students were required to study "the law" as found in textbooks, a process very largely of memorizing decisions and principles as summarized and digested by the writers of the textbooks. Dean Langdell of the Harvard Law School, believing this to be the wrong method, developed the case-book method, which requires the students themselves to study and digest the cases and extract the correct principles, just as they will have to do later when practicing; and this method is now followed widely in law schools, although textbooks are still used to some extent. In business training, the Harvard School of Business Administration follows the same principle to some extent in its use of the problem method, which consists in training the students to solve problems taken from actual business life.

QUESTIONS

1. Define profits. For what functions are they received? Distinguish wages of management from pure profits.
2. In competitive areas of our economy profits tend to be balanced by losses. Why? Why must they include wages of management, even in the long run?
3. Name some of the dynamic changes that may yield pure profits in the short run in a competitive economy.
4. Why are profits not analyzed in terms of demand and supply, like wages, interest, and rent?
5. How could an employer make pure profits by exploiting labor when other employers are bidding for it? Is it conceivable that an employer might reap losses because of exploitation by a labor union? If you think it is, give an illustration or two.
6. Could a purely competitive producer make a profit by exploiting consumers? Could a monopolistically competitive producer do so? Does consumer rationality have anything to do with the question?
7. Why are farmers willing to work year after year when they never earn pure profits?
8. A farmer's net income averages $10,000 a year for twenty years. Is this, or any of it, pure profits? Why or why not?
9. "Profit is merely one form of wages and is essentially in strict parallel with wages. Had usage so decreed, the two terms might well have been merged. Anywhere that wages are high, profits may also be expected to be high." Do you agree? Explain.
10. In what respects do profits resemble rent? Could you call them "quasi-rents"?
11. Why do pure profits tend to disappear in a competitive industry, and to persist in monopoly?

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[12] Alfred Marshall, *Industry and Trade*, p. 356.

12. Must the profits be higher for entrepreneurs in unusually risky businesses? On what theory of the character of businessmen do you base your answer?
13. Since the only pure profits that tend to persist in the long run are monopoly profits, a tax on profits will not reduce enterprise appreciably and will be a reasonably fair tax. Do you agree? Discuss fully.
14. If the most efficient manufacturers of cotton cloth are making 25 per cent on their investment and the least efficient or marginal producers are making 7 per cent, will the price of cotton cloth tend to rise if, through taxation, the government confiscates all profits above 20 per cent? Explain.
15. "For unto everyone that hath shall be given, and he shall have abundance: but from him that hath not shall be taken away even that which he hath." Give illustrations of this great economic law.
16. Why are profits, including wages of management, low in individual retailing and the small service industries? Why are they high for the producers of patent medicines, drugs, and cosmetics?
17. What are some of the difficulties in distinguishing earned from unearned profits?
18. The Pratt and Whitney Aircraft Corporation was reported to have realized a total return of 1,142,725 per cent between 1925 and 1932. Were these profits "earned"?
19. Mention some of the essential characteristics of successful entrepreneurs. Would it be fair to summarize them by saying that the characteristics of businessmen are such as enable them to survive in business?
20. The owners of privately owned public utilities insist that there are no profits in this field because the rates are regulated. What evidence is there to the contrary? Name some monopolies which earn no profits.
21. If wealth is the basis of our humane and tender sentiments, are not our businessmen the "backbone of modern civilization"?
22. Michael Faraday worked for a salary of £100 a year at the Royal Institution and, through his observations of electricity and magnetism, laid the basis for the telegraph, the radio, and the increasing use of the new force, electric power. Who got the profits from his work?
23. "The easier a business is to enter, the lower the profits earned." Why?
24. "It is profits, monopoly profits, that make our economy a 'scarcity system.'" Do you agree? Argue that our economy would work better, would provide more jobs and more goods, if there were no pure profits.

Chapter 33.

Public Finance: The Government's Share

SENATE FINDS 2 BILLION MIGHTY HARD TO OBTAIN

Diary of the United States senate trying to find 2 billion dollars that it already had spent, but didn't have:

Monday—Soak the rich.

Tuesday—Begin hearing from the rich.

Tuesday afternoon—Decide to give the rich a chance to get richer.

Wednesday—Tax Wall Street sales.

Thursday—Get word from Wall Street: "Lay off us or you will get no campaign contributions." So Thursday afternoon decide: "We was wrong about Wall Street."

Friday—Soak the little fellow.

Saturday—Find out there is no little fellow. He has been soaked till he is drowned.

Sunday—Meditate. Next week same procedure, only more talk and less results.

Yours,
Will Rogers.

Not all the income goes directly to labor, owners of capital and land, and entrepreneurs. An increasing proportion of it goes to the government to pay for its expanding functions. The government pays out a share of its income largely as wages to labor and interest on capital. It seldom rents land, but almost always buys what it needs, and receives "implicit" rent on it; and it does not hire entrepreneurs in the true sense of the word, because those in charge of government enterprises do not seek a profit for themselves. Although government revenues thus go ultimately to one or another of the producing factors, these revenues demand separate consideration; for to the extent of government activities—at any rate beyond the elementary functions of preserving order, safeguarding property rights, and enforcing contracts—we have not capitalism but socialism. Nowhere is the trend away from private enterprise so clearly evident as in the increase in government functions and the rising burden of taxes.

The rise in government expenses

Government expenses have risen steadily since the establishment of our national government. The per capita cost of the federal government was about $1 in 1791; in the seventy years from then to the beginning of the Civil War it rose to $2; before the First World War it was $10; in the years before the Second World War it amounted to $70, and during that war it soared to around $600. In 1945, the war budget called for more than 50 per cent of the national income.

The expenditures of our state governments have risen less than those of the federal government, yet their total increased almost 1000 per cent between 1903 and 1928. Until the outbreak of World War II, the cost of municipal government roughly paralleled that of the federal government; the per capita expenditures of Boston, for instance, rose from $3.69 in the period 1818–1821, to $76.34 in 1922.

Disregarding for the present the increased cost due to war, to what causes shall we attribute this inexorable rise in the expenses of government? Clearly, one cause lies in the fact that a majority of the people want the government to do more for them, because they vote for the increases. They do not like to pay the taxes this requires, and many of them complain bitterly of our government's "extravagance" and "waste" and "bureaucracy" and, in some cases, "crookedness"; but most of them seem unable to understand the connection between government functions and taxes, and when someone starts a campaign for a new school building or an armory or a memorial building or a park improvement, they jump onto the bandwagon and ride to the polls to vote for it.

The people want the government to do more for them. With greater wealth and rising incomes, they are in a position to spend more for government services, just as they can spend more for privately produced goods and services. The people spend more for furnaces, automobiles, radios, electric refrigerators, and tiled bathrooms; and so do they vote for government expenditures for better schools, paved streets and highways, more public parks, libraries, museums, and hospitals, and better armies and navies. Lutz cites figures which suggest that from 1890 to 1913 public expenditures rose less rapidly than the national income, but that between 1913 and 1926 they rose somewhat more rapidly.[1] Certainly, after the onset of the depression in 1929, they rose much more rapidly than national income, at first because of the cost of public relief and "pump priming," and later because of the cost of the war.

In the second place, technological advances, the increasing interdependence of people and sections, and the growing complexity of our economic system call for more administrative and regulatory activities of various kinds. The largely self-sufficient pioneer farmer or small-town dweller did not require many government services beyond those of a sheriff or constable, a road overseer, a school teacher, and a few county officers. Today people who live in cities —where, thanks to the advances in technology an increasing proportion of the people live—demand and must have the services of many public officials. As the city water system superseded the farm well, as the electric light replaced the kerosene lamp, as the street car and bus displaced the horse and buggy, personal responsibility yielded more and more to public, collective responsibility, and public functions increased in number and importance. The growth of cities also created new demands for health protection which were met by the development of medical and sanitary services, partly as a public function.

A third reason for the rise in public expenditures is the growing humanitarianism of recent times, itself largely a result of the wealth and comfort of the machine age. No longer do we view with indifference the plight of unfortunate people, but we provide various means of alleviating their hardships. The cost of this relief has been rising for many years, but with particular rapidity since the beginning of the Great Depression. More and more we try to protect labor, to provide in some way for the defective and the indigent—if not very well, at any rate far better than we did a few decades ago. Even criminals receive far more humane and generous treatment than they did a generation ago, but at greater expense, of course.

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[1] Harley L. Lutz, *Public Finance*, 2nd ed., pp. 87 ff.

In the fourth place, this growing humanitarianism has been accompanied by the development of political democracy; and, as Groves says, "Democracy tends toward liberal spending." If today, as in colonial days, there were a property qualification for voting, property owners would doubtless be less inclined to vote for expansion of government expenditures. Not only has the vote been extended to a larger proportion of the people, but a smaller proportion of the people own property in any considerable amount.

In the fifth place, it is often contended that a government agency, once established, continually strives to expand its functions and its staff, and that this is an important cause of the increase in government expenditures. There is some truth in this, particularly for the agencies and departments which have grown very large. In some states, the highway department has become a strong enough political force to influence its own appropriations to some extent. Particularly is this true where state highway departments provide healthful summer employment for football players of the state schools. The Army and Navy Departments in Washington are often able to wield considerable political power in the direction of generous appropriations for defense. Generally, however, although most government departments and bureaus naturally regard their work as important and try to secure funds for expansion, they can do so only if they have a case which will impress the legislators more strongly than the public clamor against high taxes. The main cause of increasing government expenditures is not to be found here.

In the sixth place, the responsibility for our increasing public expenditures, and for some other critical problems as well, must to some extent be charged to the organization of government powers set up by our Constitution. The President represents the people of the entire country and is responsible to the entire country; but Senators and Congressmen represent only their own states or congressional districts and are responsible only to the people therein. They are not ordinarily held responsible for the failure of broad governmental policies, such as the balancing of the budget, if they get something for the home folks; and the result sometimes is that, through logrolling and vote swapping, they pile up federal expenses unreasonably. When the bonus legislation was under consideration, for instance, several Presidents vetoed the various bills; but Congress, not daring to oppose the bonus on the grounds of economy, finally passed it over the presidential veto. President Franklin D. Roosevelt was often accused of gross extravagance in government affairs, and with some justice; yet it is doubtful if his record was worse than that of Congress.

The common charge that government inefficiency and graft are causes of the rise in public expenditures is certainly invalid. Extravagance there has been at all times, but the general trend in government activities has long been toward greater efficiency and higher standards of integrity. This will be evident to anyone who reads the sordid story of federal, state, and municipal government during the past century.

For various reasons, federal expenditures have risen more rapidly than those of the states. One cause is the vast increase in war expenditures, which are paid by the federal government. Another important reason is that with our more efficient transportation and communication, and the consequent closer integration of the country, state lines mean much less than they once did, and the federal government has assumed some functions that once belonged to the states, or in some cases to the local government units. When people rode in wagons and buggies, most roads were cared for, if they were given any care at all, by the township road overseer. Later, when the automobile came in and better roads were needed, the states assumed much of this responsibility; and still later, when interstate traffic became important, the federal government assumed part of the cost of road building. Similarly, in the apprehension of criminals, a function once assumed by the county sheriff, town marshal, or city police, the federal government is taking an increasingly important part through the Federal Bureau of Investigation, and at a great increase in the risks attending criminal adventure. The federal government probably will expand its functions at the expense of the states even further, because many that now belong to the states, such as the regulation of corporations, can be performed better by the federal government.

Federal expenditures

Before World War II, the federal government spent about a billion dollars for national defense and about 7 billions for other federal functions. In the fiscal year ending June 30, 1945, it spent 88 billions for national defense, and nearly 11 billions for other purposes. Estimates for the fiscal year 1946, the first postwar year, run as follows (in millions of dollars):

National defense	$69,400
Interest on the public debt	4,500
Tax refunds	2,725
Veterans' pensions and benefits	2,612
Aids to agriculture	410
Social Security program	498
Work relief	14
Retirement funds (government employees)	489
General public works program	394
General government expenses	1,143
Supplemental items and adjustments	347
Total	$82,532

The cost of war has thus risen to fantastic figures. The First World War is estimated to have cost all the nations involved a total of 211 billions, exclusive of allowances for lives lost and other non-monetary losses. The cost to the United States was more than 40 billions. The Second World War cost us about twice this amount, *annually*. Why this astronomical increase? Of the many causes for it, the most important is the complexity and expensiveness of present-day weapons, and the vast scale on which wars are now fought, on sea, on land, and in the air. A modern battleship costs 60 million dollars or more; a superbomber, half a million; a heavy tank, $114,000; it costs about $1000 to fire one 16-inch cannon. The equipment used on a battlefront of 300 miles costs hundreds of millions of dollars and it is worn out rapidly. The government spends some $50,000 merely to train a bomber pilot.

Obviously a nation fighting for its life will not skimp on military equipment but will buy all it can afford; and, for a rich nation, this is of course a great deal. The cost of such equipment is high, partly because much of it represents emergency and consequently high-cost production, and partly because the monopolies controlling the production of most war equipment take advantage of the government's sudden and imperious needs.

Other federal expenses have been increasing too, but much less rapidly; and the increase has been due largely to the growing cost of veterans' pensions and interest on the public debt, both indirect war expenses. Veterans' pensions, which cost 550 million dollars in 1939, rose to 2612 millions (estimated) in 1946, and will of course rise further in future years. Interest on the public debt, only 941 millions in 1939, rose to 4500 millions in 1946.

State expenditures

State expenditures are made largely for what are called "developmental" purposes, that is, for the general social welfare. Of the total of 5892 million dollars spent in 1943, contributions to the unemployment compensation fund accounted for 1171 millions, schools 1113 millions, highways 965 millions, welfare expenditures 913 millions, hospitals 267 millions; smaller sums were spent for public safety, health, correction, libraries, interest on debts, recreation, and conservation of natural re-

Local expenditures

Local government expenditures are made for somewhat the same purposes as those of the states, with schools, charities, hospitals, and correction constituting the most important items. Policing, health and sanitation, recreation and libraries also call for considerable

The effects of public expenditures

It is often assumed that government expenditures represent largely a waste of money, a mere subtraction from the income of society; on the other hand, many people think that government disbursements of money are beneficial, irrespective of the objectives sought, because they "put money in circulation." There is only a modicum of truth in either view. As to the first, there is indeed some waste of public funds in the sense that some public spending yields less satisfaction than would the private spending of the same amount of money. If all our people paid equal amounts of taxes and received equal benefits from government expenditures, there would be less wasteful spending; for every taxpayer would balance cost against benefit and presumably would stop voting for public spending when the marginal utility secured by publicly spent dollars just equaled the marginal utility afforded by privately spent dollars. Maximum satisfaction would thus be secured.

Unfortunately, however, not all share equally in costs and benefits. Almost everyone is familiar with the congressional pork barrel for building post offices, dredging rivers and harbors, and otherwise spending public money, sometimes wastefully, in communities strongly represented in Congress. The costs of such projects are borne by all the taxpayers in the country, but only a few receive the benefits, if any. This is more or less true of many kinds of government expenditures. Every public building, every public park or forest or highway or airfield, every government grant for any purpose whatsoever, is sure to be of much greater benefit to some than to others; and on every legislative calendar there are bills appropriating public money largely for the benefit of a few minority classes. Through the familiar political strategy of logrolling a few interested groups may combine to pass such bills, with resulting waste of public funds. Some of the shipping and air mail subsidies and the railroad and pension grants of the past were of this character, and in recent years some of the more extravagant old-age pension schemes represent efforts to raid the public treasury for the benefit of a minority group. There is always a great deal of such waste in wartime, partly because of the speed required in a national crisis, and partly because selfish interests can often take advantage of the general excitement and confusion and reach into the public purse with one hand, while waving the flag with the other.

The theory that public expenditures are beneficial because they "put money in circulation" need not detain us. They may be justified as a depression "shot in the arm," as a way of priming the pump, but we have pointed out the general fallacy of all such theories.

Despite the common criticisms of government waste and extravagance, the people probably get as much from their tax dollars as from the dollars they spend personally; but the government spends for a different type of goods and services, usually for "immaterial" ends—education, charities, health, and sanitation—rather than for groceries and automobiles and gasoline and refrigerators. For the long run its expenditures certainly seem as wise as those of most individuals. Our bill for public education is apparently not much higher than the bill for perfumery, cosmetics, and tobacco; and our public expenditures for health and sanitation are less than the amount spent for chewing gum. Although people may get more immediate satisfaction from perfumery and cosmetics and candy and gum than from education and from public health and sanitation, in the long run the latter are unquestionably more important. Much of the government's expenditures not only contribute to production, at any rate in the long run, but raise the quality of life.

The long-run view which the government takes is essential in many activities. The future welfare of the country depends on the education of the children of today, on their protection from disease and unhealthful surroundings. Conservation is necessarily a government problem. Private lumbermen made high profits by slashing the timber on the mountainsides, oil producers often found it profitable to waste all the natural gas and much of the oil; and farmers could at least make a living exploiting the virgin soil, for a while; but when it became evident that the interests of future generations were being ignored, the government had to step in. The government must expand its conservation activities very greatly if it is to guard the future welfare of the people.

Public revenues: classification

There is no perfectly logical classification of public revenues, but the following, adapted from Lutz, will serve as well as any:[2]

1. Commercial revenues
    - Public industries
    - The public domain

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[2] *Ibid.*, pp. 140–141.

2. Administrative revenues
    - Fines
    - Fees
    - Special assessments
3. Taxation
4. Public loans

COMMERCIAL REVENUES

Public industries

Public industries are much less important in the United States than in some other countries. In several European countries, and in Australia, New Zealand, and Canada, the government, national or state, operates some or all of the railroads; in France and several other countries the government conducts the tobacco industry as a state monopoly; and various cities throughout the world operate some or all of the public utilities. Our federal government has no important industries, except the post office, certain types of banks, and a few giant hydroelectric plants, including the Tennessee Valley Authority and the Boulder and Grand Coulee Dams. None of these were established for the purpose of securing revenues, and none have yielded net revenues; in fact, most of them were unattractive to private enterprise—a common reason for government operation.

The states, like the federal government, engage in few commercial enterprises, although North Dakota has experimented with state operation of a bank, a flour mill, and terminal elevator, and with building homes, all of which yielded deficits instead of net revenues. Cities have gone much further. Most of our city water systems are municipally operated, as are a considerable number of electric and gas utilities and street railway systems. Some cities operate wharves, docks, and public markets as a needed public service, not as a means of raising revenues.

If we could appraise correctly the results of the municipal operation of utilities, we could throw some light on the problem of private enterprise versus socialism; but it is difficult to assay the results and draw definite conclusions. Students of the problem are by no means in agreement. Some assert that municipally operated utilities are usually subject to politics, badly managed, and unprogressive, and that their rates are no lower than those of the privately operated utilities; others insist that they are no more subject to political pressure than the private utilities, that their management is quite as good, and that their rates are generally lower. From the mass of conflicting evidence and opinion, a few conclusions seem justified. There is no reason to believe that municipal operation is more subject to politics than private operation, although it may be subject in a different way. Privately operated utilities have often exerted a corrupting influence on municipal affairs; in fact, it would scarcely be an exaggeration to say that most American cities have usually been dominated to some extent by them. Cities ruled by corrupt machines, as most of our cities have been, are in somewhat the same position whether the utilities are privately or publicly operated. Privately operated utilities are likely to corrupt the government, and publicly operated utilities are sometimes corrupted by the government. Privately operated utilities are often exploited by financial insiders, and publicly operated utilities by political insiders. In either case, the public pays the bill.

As to management, some municipal plants have been badly managed by incompetent political appointees, but some privately operated plants—those in the Insull and Hopson holding companies, for instance—have also been mismanaged and exploited. On the other hand, some municipal plants have been managed very well and have offered exceptionally low rates; some have made enough profit to pay a considerable part of the general expenses of the city. Here again the character of the city administration is the decisive factor. With an honest and efficient administration, a city is likely to secure fair service from its utilities, whether they are privately or publicly operated; with a corrupt or inefficient government, it is likely to have poor service regardless of how the utilities are operated. There is this qualification: however well a city may be governed, it cannot regulate utility rates effectively, because such rates are regulated not by the city, but by a state commission; and rate regulation is not generally effective.

The public domain

Unlike publicly operated industries, the public domain is very important, although it yields no net revenue but on the contrary is maintained at a net expense to the Treasury. When the national government was established, Alexander Hamilton, Secretary of the Treasury, adopted the policy of selling the public domain, in large or small tracts, in order to raise badly needed revenues for the new government. In 1841 the Preemption Act provided for settlement in tracts of not more than 160 acres, and payment of $1.25 an acre; and in 1862 the Homestead Act abandoned the idea of revenue entirely, allowing settlers to take up 160 acres of land and receive a title free, after five years of occupancy and cultivation. Still later, about 1891, the government began to shift from this policy of rapid settlement to a policy of reservation of most kinds of public lands, as a result of which we have a public domain of considerable magnitude. The new policy was adopted not with the idea of gaining revenues from leasing the public domain but rather to conserve it; and there is little chance that it will yield any considerable net revenues, at any rate for many years in the future. Most of it is land that private interests did not appropriate because they did not think it worth taking

ADMINISTRATIVE REVENUES

Administrative revenues accrue from various administrative functions of the government which are conducted not for the sake of revenues, but because they are necessary to the general welfare. They are most important in local governments. *Fines* are or should be imposed not for the purpose of securing revenues but to preserve the peace. A violation of this principle used to be seen in the arrest and fining of passing motorists by the constables of small towns through which important highways run. *Fees* are supposed to cover merely the cost of the service rendered, although they are often too high or too low for that; when too high, they become to that extent taxes. *Special assessments* are often levied against real property to cover the cost of improvements, street paving for instance, which are presumed to benefit the property. They are supposed to be limited to the amount of the benefit received, but actually they are sometimes assessed with little regard to benefits. For all these reasons, there is much to be said against administrative revenues, particularly fees.

TAXATION

Taxes yield almost all the revenues received by the federal, state, and local governments, except those secured by borrowing. In 1937—to take a year before the Second World War—the total tax revenues of the various government units were $12,500,000,000; of this, the federal government received $5,000,000,000, the states about $3,000,000,000, and the local units, including the cities, about $4,500,000,000. This was approximately $100 per capita and constituted about 18 per cent of the total national income, obviously a fairly heavy burden. In 1944 the total tax revenues had risen above 50 billions.

Theories of taxation

Before analyzing the tax systems of the various government units, it will be well to consider certain questions relating to the general theory of taxation; and our initial task is to distinguish between two theories of the function of taxation, the pure financial and the politico-social. According to the pure financial theory, the function of taxation is to get the money needed, in the cheapest and fairest way possible, without much regard to the effects of the taxes or expenditures on the distribution of income among the different classes of society, and with no program for remaking society in any way. Taxes should not be too heavy and should be proportional to income rather than progressive—at a higher rate on the larger incomes. The politico-social theory, on the other hand, looks to the use of taxation as a means of social reform. It calls for progressive taxes and generous expenditures for the benefit of people with low incomes.

This country, like all the others, is moving in the direction of the politico-social theory; for as the burden of taxation increases, it becomes more and more necessary to consider its effects on the social well-being. Various tax measures, both federal and state, have followed the politico-social theory to some extent, with the clear purpose of changing our society in one way or another. Our steeply progressive income and death taxes are designed to reduce economic inequalities and establish a more democratic society; our sales and poll taxes tend to make society more aristocratic; heavy taxes on cigarettes and liquor are intended to discourage injurious and sinful habits; corporation income taxes, graduated according to the size of income, are designed to reduce the size of corporations and even to discourage the corporation form of business; severance taxes, imposed on current yields of timber and minerals, are to a slight extent calculated to discourage the exploitation of natural resources and encourage their conservation; taxes on chain stores tend to preserve individual proprietorships in retailing; heavy hunting licenses tend to conserve wild life.

Justice in taxation

A great deal is said about justice in drawing up tax programs; but unfortunately the word "justice" is very difficult to define. Almost every tax has been defended as just or condemned as unjust. Yet the concept of justice is not quite meaningless. It may be said, for instance, that there is some justice in almost any *old* tax, and that a *new* tax inevitably imposes injustice. Let us assume that the tax system has been unchanged for thirty years, that all the taxes are old, and their rates the same for all these years. There has been time for people to become accustomed to the taxes, to take them into consideration in their business calculations. The prices of farm lands have been adjusted to the land tax; city homes sell at prices which allow for the taxes on such property; most businessmen have chosen their fields of activity with due allowance for the taxes they must pay; salaries have been adjusted to the taxes imposed on incomes. In such a situation brewers or saloon keepers would have no right to complain if their taxes were high, because they would have entered the business with full knowledge of the fact that the taxes would be high. Now suppose that the tax system is revised and the rates on some businesses and some kinds of property are raised, and on others lowered. Clearly some injustice will be done, for some people will reap unearned gains through the reduction and others will suffer unmerited losses. This does not mean that the tax system should never be changed, for bad taxes should be replaced by better ones whenever possible; but it does show that there is some logic in the claim that old taxes are just and that new ones involve injustice.

Apportionment of the tax burden

There are various theories as to the proper apportionment of the tax burden, but we shall consider here only three: the *benefit theory*, the *ability theory*, and the *minimum sacrifice theory*. According to the *benefit theory*, the tax burden should be imposed on the various taxpayers in proportion to the benefits received from the expenditure of the tax revenues. There is a measure of validity in this theory, and it is employed in the imposition of many fees and of all special assessments. The gasoline tax squares with the theory fairly well, if the proceeds are used only for road construction and maintenance. Generally, however, the benefit theory is of little use in formulating an enlightened tax system. For one thing, it is impossible to calculate the benefit which a taxpayer receives from any given government expenditure. Moreover, it would be practically impossible to apportion most taxes on this basis, for the poor receive perhaps even greater benefits from many government services than the rich, yet they could not pay taxes in any such proportion.

The *ability theory* meets the practical requirements of a tax system better, even though the taxpaying ability of a particular individual cannot be determined exactly. Ownership of property was at one time thought to be a satisfactory criterion, but, particularly in recent years, many farmers and others who own considerable amounts of property have had small net incomes. The best test of ability would perhaps be net income; yet it might make a great deal of difference from what source the income is derived—from property, for instance, or from labor. A man who receives $2000 a year from property he owns is in a much better position than a man who earns the same amount for his labor because the latter's income ceases in the event of illness or incapacity.

A common argument against the use of the ability theory is that it may penalize the able, energetic, and thrifty for having got themselves in a position where they are "able" to pay taxes; while it rewards the weak, lazy, and shiftless with tax exemption. To the extent that wealth, income, and taxpaying ability are the result of natural, hereditary qualities, this may not seem unfair or unjust, for the strong may properly be expected to carry a tax burden proportioned to their strength, but to the extent that wealth and income are the reward of hard work and saving, there is an element of unfairness, and even social folly, in penalizing the successful with heavy taxes. In spite of all this, however, the ability theory must be weighted heavily, if for no other reason than because when the government needs revenues it must go to those who are able to pay.

The *minimum sacrifice theory* of taxation calls for such apportionment of taxes as will involve the minimum total sacrifice, which means equal sacrifice for all. There is nothing wrong with this theory as an ideal, and it is used to some extent—in the income tax, for instance, which levies a higher rate on large than on small incomes—but it results in somewhat the same tax system as the ability theory. In weighing sacrifice, however, we must distinguish between direct and indirect sacrifice. If only direct sacrifice is to be considered, this theory would call for extremely high taxes on the rich and complete exemption of the poor, because the rich could pay a great deal with less sacrifice than the poor could pay even a little. With the direct sacrifice, however, must be included the possible indirect sacrifice resulting from taxation—reduced incentives for enterprise, savings, and capital investments, and therefore reduced production of goods. The poor might sacrifice a great deal, indirectly, if all the taxes were paid by the rich, for this might kill the goose that lays the golden eggs. It is doubtful if we have generally taxed the rich so heavily as to bring these unfortunate consequences, but it is not outside the realm of possibility.

The tax burden and economic classes. All this brings up the question as to how the burden of taxation should be apportioned among the various economic classes—the rich, the poor, and the middle classes. *Regressive taxes* bear most heavily on people of small means. General sales taxes are regressive, because people of small means spend a larger proportion of their income for commodities subject to sales taxes, and therefore pay a higher rate on their income than the rich. The tariff is for the same reason regressive. *Proportional taxes* bear equally, that is, at the same rate, on people of different incomes. The general property tax, levied at a certain rate on property of all kinds, is proportional, as would be also an income tax levied at the same rate on all incomes. *Progressive taxes* are levied at higher rates on the higher incomes. The income tax is progressive in practically all countries.

Few people argue openly for regressive taxation, although most of the well-to-do business classes favor taxes which *are* regressive—sales taxes and tariffs, for instance. The usual tax arguments relate to progressive as opposed to proportional taxation, and to the rate of progression to be adopted. The history of our tax policy is to some extent the story of a continuous battle between the rich and well-to-do on the one hand, and the poorer classes and certain social-minded intellectuals on the other, the former fighting for regressive and proportional taxation, and the latter for progressive taxation. During most of our history, the former were in control, and the federal, state, and local tax systems were generally regressive or proportional; but when the Constitution was amended and the federal progressive income tax was adopted in 1913, the pendulum swung in the other direction, toward heavier income taxes and steeper rates of progression.

Arguments for and against progressive taxation. One argument in favor of progressive taxes holds that the principle of progression squares with both the ability and the minimum sacrifice theories. A man with a large income can pay a greater proportion of his income in taxes than a man with a small income. An income of $10,000 a year is only five times as large as an income of $2000; but if we assume that $1500 is required for a decent living, the man with $10,000 has seventeen times as much above decent living requirements as the man who receives $2000, or $8500 as compared with $500. With a 25 per cent income tax, he will sacrifice much less in paying $2500 than the poorer man will in paying $500, because he will still be able to afford the essentials of a fairly luxurious life. This principle stands out even more clearly in the taxation of huge incomes, those, let us say, of $100,000 and over. Taxation of such incomes, even at very high rates, does not deprive the recipients of any important comfort or luxury, but only of the prestige and power which very large incomes give. Some even argue that the steeply graduated taxation of such incomes does not diminish the prestige satisfaction of the rich appreciably as long as it leaves them in the same relative position as before. Those who were wealthiest before are still the wealthiest; John Doe is still a jump or two ahead of Richard Roe—albeit a shorter jump—and the social hierarchy is not altered appreciably. The argument seems sound, as far as the prestige value of income is concerned; but of course the power of the rich—economic, social, and political power—would suffer from high taxation.

A second argument for progressive taxation holds that it is needed to reduce the grotesque inequalities of wealth which make political democracy difficult to maintain. Most people do not distinguish between economic and political democracy and placidly assume that because each man has one vote—perhaps if his skin is white and he has paid his poll tax—American democracy is on a firm foundation. Students of political science insist, however, that an economic oligarchy like the United States cannot be a political democracy in the best sense; that inevitably a few powerful capitalists and financiers will assume power in political affairs which is inconsistent with genuine democracy; and that the only way to maintain a real political democracy is to restore economic democracy through progressive taxation or otherwise. This of course follows the politico-social theory of taxation.

A third argument for at least a few progressive taxes claims that some taxes are regressive and should be balanced by progressive taxes. Sales taxes, poll taxes, and customs duties are regressive and should be balanced by progressive income and inheritance taxes to make our tax system as a whole proportional.

A number of arguments have been advanced in opposition to progressive taxation. Its opponents maintain that it is unfair and unwise to discriminate against our most productive class, the men who, according to the implicit assumptions of a capitalist society, have prospered greatly because they have contributed greatly. They argue that disproportionately heavy taxation of the rich tends to slow down the accumulation of wealth in two ways: by discouraging the most capable classes from putting forth their full energies, and by taking money from the class which would save the largest proportion of it. These arguments call for some consideration.

As to the unfairness of progressive taxation, it must be conceded that if wealth and income were distributed strictly in proportion to social contribution, there might be an element of unfairness in taxing the rich at a higher rate than the poor. Indeed even proportional taxation involves an element of unfairness. An industrious, thrifty, capable farmer builds a good home and contributes generously not only to the supply of farm products but to the economic and social welfare of his community, and we reward him with heavy taxes on the wealth he has created; whereas a lazy, shiftless, incompetent farmer exploits his land, builds nothing, lets what buildings he has fall into decay, produces little farm stuff, and contributes little to his community's economic and social life, and we reward him with reduced taxes. Any tax on man-made wealth or on the income therefrom is a penalty on industry and thrift and an encouragement to laziness, improvidence, and incompetence. Yet it is inevitable that taxes should be levied in this way because the state must get revenues from people who have money. Furthermore, the case of the industrious farmer, in a highly competitive industry, is different from that of a wealthy monopolist, or of a corporation executive who takes a salary of half a million.

As to the tendency of progressive taxation to slow down the accumulation of wealth, it is probable that the rates of progression which prevailed before the Second World War had little if any effect on the energy with which wealth was sought. It would be difficult to find many businessmen or others who received high incomes abandoning productive work because they were taxed too heavily. To the extent of their tax payments they were of course obliged to reduce their savings, but the amount of savings has been too great in recent years. If we had not employed the principle of progression in our income tax, if we had taken less from the rich, and therefore had necessarily taken more from the poor and middle classes, we should have greater inequalities of wealth, our economic system might work less efficiently than it does, and there might be less wealth rather than more.

It is sometimes argued that progressive taxation, particularly if the rate of progression is very steep, leads to evasion. Jensen suggests, however, that while very high taxes do tend to encourage evasion, their progressiveness does not appear to make much difference.[8] Presumably the rich would under no circumstances pay more than they have to—that is, they would evade taxes when possible—for even under proportional taxation their taxes would be large enough so that it would be worth their while to hire lawyers to help keep them as low as possible. The rich can frequently evade taxes in various ways, even when people with smaller incomes are obliged to pay, because the small fry cannot afford to hire good lawyers or to set up the corporations so often used in tax evasion; but the rich would generally be able to do this whether taxes were progressive or not. One practice employed by the rich, the purchase of tax-exempt bonds, is often referred to as tax evasion but is not really evasion at all. When a man buys at par a 2 per cent tax-exempt bond when taxable bonds are selling to yield 3 per cent, he is not evading taxes; he is paying them in a lump sum.

Whatever our conclusion as to the wisdom of progressive taxation, there is little doubt that it is here to stay. The arguments will concern merely the rate of progression to be applied.

Requirements of a sound tax system

A sound tax system should have the virtues of adequacy, economy, convenience, elasticity, simplicity, and diversity. It must be *adequate*, because the government must have a certain amount of revenue; and no matter how attractive a tax system may be in other respects, if it will not raise the revenue needed, it will not serve. The system should be *economical*, first, in collection costs, because these costs, which must be paid by the taxpayers, yield nothing for the government and therefore represent waste; and second, in the sense that it should cause the minimum indirect harm through discouraging industry, enterprise, or thrift. We have seen that the tariff, as a tax which imposes on consumers a burden of costs that is several times as great as the revenue accruing to the government, grossly violates this principle. Taxes should be *convenient* to pay, as to time, place, and manner of payment. Inheritance taxes violate this canon conspicuously, unless the period in which payment may be made is fairly long; for they may not be paid in installments and hence may require the sale of some of the assets of an estate at an inconvenient time or in a poor market. When aluminum coins were used, sales taxes grossly violated the canon of convenience in small purchases, for the tax collected was sometimes not enough to pay for the time and trouble involved in collecting it. This meant a 100 per cent cost of collection.

Not all the taxes in a tax system need to be *elastic*, but some must be elastic enough to permit adjustment of the revenues to changing needs. The income tax provides a fair amount of elasticity for the federal budget. A tax system should be as *simple* as it can be made, although, as Lutz points out, "The form of a tax can never be more simple than the economic facts to which the tax is applied." The federal income tax was at one time so complicated that leading tax authorities could hardly understand some of its provisions, but it was later simplified and clarified somewhat. Finally, a sound tax system should be *diversified;* it should include a number of taxes, properly coordinated. Diversity is a requisite, not only because no one tax can yield enough revenue but because a diversified system will to some extent equalize the injustices that always result from the imposition of a tax. Diversity is desirable for the additional reason that it subjects the maximum number of people in every class to some form of tax, and so to some extent tends to make everyone conscious of the burdens and responsibilities of citizenship. A large number of people exempt from all or nearly all taxes might well be a social menace, for they might vote for heavy government expenditures without due thought of the costs involved.

The shifting of taxes

Before taking up the analysis of the American tax system we must consider one more group of theoretical principles, those relating to the shifting of taxes. A tax may not be paid in the long run by the one on whom it is levied, but may be shifted to others through an economic process which we shall now discuss. It must not be supposed that this shifting is colored with illegality or dishonesty, for it is a purely economic process; and a tax may be imposed with the express intention that it will be shifted. This is true of the excise taxes on cigarettes and liquor.

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[8] Jens P. Jensen, *Public Finance*, p. 220.

Taxes may be shifted either forward or backward, or in part forward and in part backward. The tax on the manufacture of tobacco, for instance, may be shifted forward to consumers or backward to the tobacco growers, or partly in both directions; and the extent to which the tax will be shifted in each direction will be determined by the relative position of consumers and producers. Or it is possible that the manufacturers may be unable to shift all the tax, may pay part of it themselves and shift the rest forward or backward.

A tax that is assessed as a certain amount per unit of output raises the supply or cost of production schedule and shifts the point of intersection of the cost and demand schedules to fix a higher price for a smaller output; but the relative extent to which price and output are affected depends on elasticity of demand and supply, the slope of these two curves.[4]

The extent to which a tax can be shifted and the way in which it may be shifted depend on whether the industry taxed is purely competitive, monopolistically competitive, or monopolized. In the chapter on long-run competitive price we analyzed the shifting of taxes imposed on commodities produced competitively, at increasing, constant, and decreasing cost. A tax on such a commodity must theoretically be shifted, for producers are presumably selling at cost, and cannot sell for less in the long run.

For monopolistically competitive industries, the shifting of taxes is somewhat more complicated, because such industries vary widely with respect to the relative amount of competition and monopoly in their market situations. A monopolistically competitive industry which deviates only a little from pure competition, such as the cotton manufacturing industry, makes little or no pure profits, and a tax will tend to be shifted largely to consumers through the elimination of the highest-cost producers. These producers will be making only enough to cover costs before the tax is imposed, and the tax will raise their costs above their average revenues and so eventually force them out of business. This will reduce the output, and prices will rise enough to cover all or most of the tax. In an industry which more nearly approaches monopoly, prices may be far above the costs of manufacture; but if selling costs are high, as for instance in the sale of certain cosmetics and toilet articles, there may be no pure profits. In this case, the producers may be able to cut advertising or selling costs enough to meet part or all of the tax. To the extent that advertising results merely in taking business away from each other—that is, to the extent that it is mutually self-canceling—a reduction in it would not decrease sales, and the producers could assume the tax without loss. It is unlikely that all the tax would be absorbed in this way, but some of it might be; the rest would be shifted forward or backward, doubtless mostly forward onto consumers. This analysis suggests as a corollary that a tax on advertising might be nearly burdenless since it would merely reduce the amount of mutually self-canceling advertising, and so would cost the producers nothing and would not raise prices.

A tax imposed on commodities produced under conditions of monopolistic competition in which the producers make monopoly profits will be similar in effect to a tax on a monopolized product produced at a profit; and to this we now turn. Let us suppose that a tax of 2 cents a pound is imposed on the production of sulphur, and that the sulphur monopoly, selling at a price of 10 cents a pound, has been making a monopoly profit of 4 cents. Fig. 42 shows that the sulphur monopolist formerly produced 10 million pounds at average total unit costs of 6 cents. Now he finds that the tax raises his marginal costs and average total unit costs by 2 cents and establishes new curves, *M′C′* and *A′T′U′C′*. The *M′C′* and *MR* curves now intersect to fix his output at 9 million pounds, which is produced at average total unit costs of a little less than 9 cents and is sold at 11 cents. The tax of 2 cents has raised the selling price 1 cent, and the producer is making a monopoly profit of a little over 2 cents. In other words, he has shifted half of the tax.

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[4] The student should draw graphs to illustrate different situations. It will be well for him to review the general principles of price determination at this point, for the shifting of taxes offers excellent illustrations of the principles of price determination.

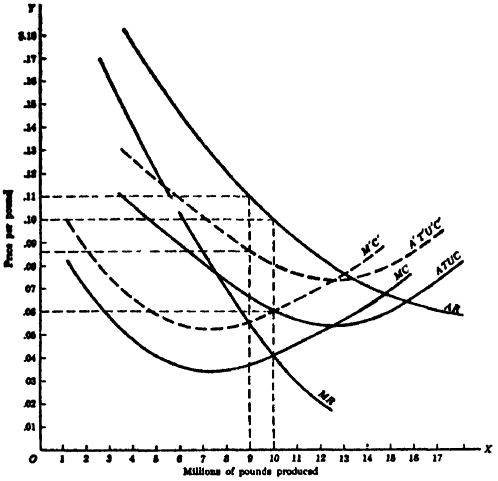

FIG. 42. A Tax on a Profit-Making Monopoly.

But suppose the tax is imposed not on the unit output but as a fixed sum which will not vary with output—let us say in the form of a license tax. In a competitive industry there will be no reduction of output in the short run, and no shifting of the tax. Marginal producers were formerly earning just enough to cover their average total unit costs, and now they will not be able to cover total costs, which are higher by the amount of the tax; but since the license tax represents an increase in fixed costs, which decline per unit with increased output, there is no incentive to reduce production, but on the contrary actually an incentive to increase it. An increase in fixed costs, it will be remembered, shifts the average total cost curve, and therefore the lowest point on that curve, to the right. To reach lowest costs, the individual producer will now have to increase output. This, however, will reduce price—lower the average revenue curve—and so increase his loss. The tax has really reduced the value of his physical plant by taking part of his income from it, but there is nothing he can do to shift it, in the short run.

In the long run, however, some or all of the tax will be shifted. Since producers formerly earned only enough to cover total costs, including of course fixed costs, they will now earn less than this. No new investments will be made in plant and equipment because this is now unprofitable, and some of the old plant and equipment will gradually wear out. The amount of capital in the business will decline, and therefore output will decrease, until the price rises enough to cover the tax, or at any rate most of it. Therefore in the long run the tax will tend to be shifted.

A license tax on a plant operated by a monopoly would not affect output in the short run, because the monopolist presumably would have fixed his price and output at the point which yielded maximum monopoly profits, and that same price and output will still yield maximum profits. Even in the long run it is doubtful if the monopolist can shift much of the tax, unless it is so heavy that it takes more than his entire monopoly profit. If it leaves any profit at all, or if it leaves only enough to cover total costs, the monopolist will gain nothing by reducing output, for the license tax, unlike the tax on unit output, remains the same no matter how much or little he produces. It is therefore difficult to see how he can shift the tax.

In Fig. 43, which illustrates this situation, we assume that the license tax doubles the monopolist's fixed costs and establishes a new fixed cost curve, *F'C'*, and a new average total unit cost curve, *A'T'U'C'*, but that marginal costs and marginal revenue are not affected.

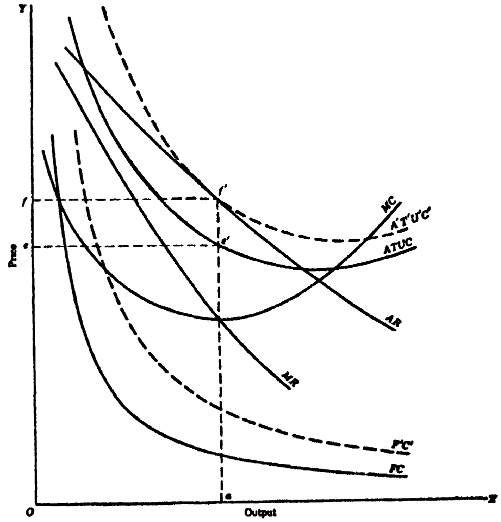

FIG. 43. A Fixed Tax on a Monopoly.

increases in output add no more than formerly to total costs. After the license tax is imposed, as before, the monopolist produces to the point where his marginal costs equal his marginal revenue; this is *Oa*, the same point as before. The price, *Of*, is also the same as it was before. The only change indicated is that the tax takes the monopoly profits *eff'e'* formerly earned by the monopolist. The amount produced is the same as before, the price is the same, and the tax is not shifted.

All this illustrates a few of the many possibilities. To discuss all the ramifications of tax shifting would be an endless job. In general, the extent to which taxes are shifted depends on conditions, particularly the elasticity, of demand and supply.[5]

Taxes are generally shifted through a reduction in the supply of the commodity taxed; and a tax that does not reduce supply is not shifted. For this reason it is usually conceded that a tax on land, proportioned to its rent, cannot be shifted. Land being a gift of nature, its supply is fixed; and therefore a tax on it must be paid by the owner, for he cannot shift it to the tenant or to consumers of the products of land or to anyone else.

A tax on certain other things which are in the nature of land cannot be shifted for the same reason. As we have seen, business ability is largely a natural gift, somewhat like land, and its supply is to some extent fixed; therefore, to the extent that income represents the wages of business ability, an income tax will not greatly affect the supply of business ability and will not be shifted, unless it is extremely high. If, however, the tax is high enough to drive a considerable number of entrepreneurs out of productive business or reduce their working energy, the supply of business ability will be reduced, the production of goods will drop, and prices will be higher. Thus the tax will be partly shifted.

It is important, but difficult, to distinguish between the shifting of taxes and certain effects of taxation. A moderate tax on the income earned by business management is not shifted; but it nevertheless reduces the amount available for private business investment, and so may reduce the amount of private productive wealth and of consumers' goods. Any tax is a subtraction from private income. To the extent that the income taken would have been invested in productive capital, any tax reduces the supply of private productive capital; and to the extent that the income would have been spent for consumers' goods, any tax reduces the consumption of privately produced goods. This, however, is only half the story. The state may invest the tax money in productive wealth, such as school buildings, public forests, land terracing, highways, and hospitals; or it may provide consumers' goods for the people in the form of parks, public orchestras, library books, and relief for the indigent. Taxes reduce the supply of private goods and substitute public goods.

Tax revenues in the United States

It would be misleading to speak of the tax system of the United States, for there are 175,000 taxing jurisdictions in this country. But the federal government, the states, and the local units have more or less systematic tax schemes, which to some extent overlap and in some respects are unscientific and out of date but are in process of being steadily improved.

Federal revenues

The federal government gets its revenues mainly from the personal and corporation income taxes, the liquor tax, tobacco tax, payroll tax, customs duties, the death tax, gasoline tax, gifts tax, and miscellaneous taxes, usually in the order named, although the relative yields of the different taxes vary considerably from year to year. The revenue accruing from the income tax, for instance, has ranged from one-third to two-thirds of the total federal revenue.

The amounts yielded by some of the most important federal taxes are estimated as follows, for the fiscal year 1945 (in millions of dollars):

Personal income tax	$18,000
Estate tax	474
Gift tax	39
Corporation income tax	4,561
Excess profits tax, current	10,630
Excess profits tax, back	892
Declared value, excess profits tax, current	123
Declared value, excess profits tax, back	31

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[5] For an exhaustive analysis of the shifting of taxes, see Otto von Mering, *The Shifting and Incidence of Taxation*.

Capital stock tax	372
Liquor taxes	2,063
Tobacco taxes (mostly on cigarettes)	921
Stamp taxes	62
Retailers excise taxes (jewelry, furs, etc.)	420
Total excise taxes	5,664
Customs duties	326
Employment taxes	1,806

The personal income tax. Prior to the Civil War, the federal government depended largely on the tariff and on the sale of public lands for its revenues, but in the stress of the war an income tax was imposed. Badly drawn, badly administered, and generally unpopular, it was repealed in 1872. In 1894, President Cleveland fathered a new income tax law, but the Supreme Court managed to find grounds for quashing this dangerous piece of radicalism as unconstitutional. The substantial industrialists of the time preferred to have the people pay the taxes in the form of a tariff, and for a while they had their way; but in 1913 the Constitution was amended to permit the passage of an income tax law, and such a law was promptly enacted. Its rates, moderate at first, were raised drastically during the First World War and have remained fairly high ever since. On our entry into the Second World War they reached heights which would have seemed fantastic a few years earlier.

The income tax applies to the incomes of both individuals and corporations, but we shall take up the personal income tax first. It would be unprofitable to discuss this tax in great detail because it is changed frequently, and will doubtless be changed further before this book appears in print. It will be sufficient to say that the law allows exemptions—larger for married than for single persons, and an additional exemption for each child—for taxes, interest payments, and similar necessary expenses; and that the tax rate ranges from a low of 19 per cent on small incomes (in 1944) to a high of about 91 per cent on the largest incomes.

The personal income tax fits most of the requirements of a good tax. It is adequate, for it yields large revenues; it is fairly economical in collection, fairly convenient to pay, and more elastic than most taxes. Unless extremely high it "stays put," that is, it is not shifted. Better than most taxes it meets the principle of ability to pay. It is not and cannot be made simple, because the economic facts to which it applies are not simple; but its complexities are not too great for fairly successful administration. The individual who pays the tax may find some value in working out a balance sheet of income and outgo, and for economists and the public there is great value in the vast amount of information on economic inequality and other important economic problems that the tax returns provide.

Aside from the common argument of conservatives that the personal income tax is an unfair and unwise burden on productive enterprise, there are certain flaws in the tax, some of them inevitable in any form of income taxation, and others due to defects in the drafting or administration of the tax law. Thus there has been a considerable amount of evasion, legal or illegal. The purchase of tax-exempt bonds, as we have seen, is not evasion; yet tax-exempt bonds present a serious problem when the government needs increased revenues. Those who have bought them cannot be made to pay more, because they paid their taxes in a lump sum when the tax rate was lower. If the tax rate were lowered, the holders of these bonds would be paying higher taxes than those who bought taxable bonds; but unfortunately tax rates have seldom been lowered. The issue of tax-exempt bonds is unwise and will doubtless be less common in the future.

A common and legal way of evading the personal income tax is the practice of "plowing back" or reinvesting corporation earnings instead of paying them as dividends to stockholders. The profits thus plowed back increase the wealth of the stockholders as truly as if they were paid to them in dividends, but for years they were not taxed as income. To correct this situation and force the corporations to pay out their earnings, President Roosevelt in 1936 secured a law imposing a special tax on undistributed corporate income; but businessmen complained bitterly about it, and two years later it was reduced so drastically as to have little effect. There is much to be said both for and against this tax. Reinvestment of corporate earnings is not altogether an evil. It has come under heavy criticism in recent years because it enabled wealthy stockholders to evade taxes, and because some business cycle authorities contend that it was one of the sources of the oversaving which prolonged the depression; but on the other hand it is argued that in profitable years corporations should be allowed to set up reserves for rainy days. It is also argued that the undistributed profits tax falls with particular weight on small, struggling corporations which are trying to build up financial strength.[6]

Still other methods of income tax evasion have been used in the past. The income tax law has permitted taxpayers to deduct from their incomes capital losses sustained during the fiscal year, and many wealthy men have escaped taxation through this provision. If they held stock which had depreciated in the market during the year, they sold it, perhaps to wife, son, daughter, or friend, thus establishing capital losses which could be subtracted from their income. In January of the following year they bought the stock back again. The government has restricted this sort of evasion in recent years. Some men have evaded part of their income taxes by various family arrangements, such as giving part of their income to members of their family through devious but legal arrangements which split the income and so reduced the rates. A man with an income of $100,000 pays a high rate on the upper portions of his income, but if he splits it with his wife so that each pays on an income of $50,000, the tax rate will be much lower.

Corporation income taxes. Corporations are subject to several kinds of taxes. The corporation income tax yielded nearly one-fourth of the federal revenues in 1941, more than the personal income tax. This tax is graduated according to the corporation's net income and in 1944 took 25 per cent of the net taxable income above $50,000. Since individual proprietorships are not subject to this tax, it clearly imposes a penalty on the corporate form; and the higher rate on large net income suggests a penalty on size. As yet, however, there is no evidence that the tax has seriously discouraged the corporate business form or that it has tended strongly to reduce the size of corporations. Whether it is shifted to the public in the form of higher prices is difficult to determine. It does not fall on marginal firms, those that are making no profits, and theoretically it should not be shifted; but actually it is probably shifted to consumers to some extent. Certainly the tax reduces the amount of funds that corporations have to invest in new capital; but it encourages corporations to keep their plants in good order and to provide liberally for depreciation and obsolescence, since by so doing they can reduce the net revenues shown, and therefore their taxes.

Corporations also pay a capital stock tax on the declared value of their capital stock, and an excess profits tax on profits above a certain percentage. These two taxes operate as a double-pronged fork to catch corporations both coming and going. If, in order to make its earnings appear moderate, a corporation declares a high value for its stock, it must pay a high capital stock tax; and if, to reduce this tax, it declares a low value for its stock, its profits may appear high, and it may be subject to the excess profits tax. Since 1943 the excess profits tax has taken 95 per cent of the excess profits, and with a yield of more than 10 billion dollars in 1945 it ranks next to the personal income tax as a revenue producer.

Death and gift taxes. Somewhat like personal income taxes, death and gift taxes are designed not only to bring in revenue but to reduce economic inequality. Death taxes may be levied as *estate taxes,* on the undivided estate of the deceased, or as *inheritance taxes,* on the separate shares transferred to the heirs. In the federal tax system the death tax is levied as an estate tax, and applies to estates of $40,000 or more; the rate is graduated from 2 to 77 per cent according to the size of the estate. This tax yielded 474 million dollars in 1945, and the gift tax, which was set up to prevent evasion of the estate tax, brought in 39 millions more.

In favor of death and gift taxes, it is argued that these taxes conform to the principle of ability to pay, that they are even fairer than income taxes because inheritances are usually unearned, and that they help to reduce inequalities in wealth and prevent the perpetuation of great hereditary estates. Opponents of such taxes claim that they violate the "natural right" of inheritance; that they reduce the incentive for industry and saving; that they are paid from capital and not from income, and that therefore they reduce the capital wealth of the country; that they tend to destroy their own bases by destroying the large fortunes that pay the taxes; and finally, that they may cause "distress selling" of the property of the estate, perhaps in a poor market, in order to raise the tax money. Whatever may be the balance of these opposing arguments, death taxes are probably here to stay. Many people have come to view large inheritances as grossly inconsistent with the assumptions of free enterprise. Whatever the justification for permitting able men to earn large incomes, there appears to be little justification for permitting them to endow their children so that they do not need to work at all. Death taxes are in effect more steeply progressive than income taxes, because the ownership of wealth is more highly concentrated than the receipt of income. Many men receive high incomes, in comparison with the number who have large estates.

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[6] See M. Slade Kendrick, *The Undistributed Profits Tax.*

Evasion of death taxes has taken various forms. The owner of a large estate may take out life insurance policies which are paid to his heirs without deduction for taxes. Much more common is the practice of giving away property before death. Such gifts, if clearly made "in contemplation of death," are taxable under the death tax; but it is often difficult to decide whether gifts are made in contemplation of death.

Consumption taxes. Most taxes are to some extent consumption taxes, in the sense that directly or indirectly they are paid in part by consumers; but certain taxes are specifically called consumption taxes. Among these are *sales taxes, excise taxes,* and *customs duties.* The federal government has sometimes levied what amounts to sales taxes on a few commodities, generally luxuries, but it does not levy a general sales tax; therefore this tax will be discussed in the sections on state and local tax systems. The federal government receives 200 million dollars a year from the gasoline tax, but most of the revenues from this source go to the various states.

The most important *excise taxes* are those on liquor and tobacco, which in 1945 yielded 2063 millions and 921 millions respectively. These taxes show clear evidence of sumptuary aims. The theory implicit in them is that liquor and tobacco are luxuries and to some extent injurious to consumers; therefore there is no great misfortune if the taxes reduce consumption. Such taxes are collected easily and cheaply by requiring manufacturers to put stamps on packages in such a way that the stamps will be destroyed when the packages are opened; they are paid with little objection or protest, and their yield is fairly steady from year to year. However, they are definitely regressive, although the fact that cigarettes and cigars are taxed much more heavily than pipe and chewing tobacco may indicate an intent to correct this fault. The idea appears to be that aristocrats use cigarettes and cigars, and the plebians smoke pipes, roll their own, or chew.

At one time *customs duties,* or tariffs, supplied most of the federal revenues, but recently they have declined to a minor position, yielding only 326 million dollars in 1945. We have already seen that they are regressive, that they often impose a burden on consumers far greater than the revenue received, that they have grave repercussions on international relations, and that they have indeed been an important cause of the decline of capitalism. They may well represent the worst form of taxation employed by the federal government.

Pay-roll taxes. Pay-roll taxes yielded nearly a billion dollars in 1941, but these funds are earmarked for the expenses of social security. Part of the taxes are paid by employees and part by the employers; but theoretical reasoning leads to the conclusion that, in effectively competitive industries, the employers' payments in the long run tend to be shifted largely to employees through lower wage rates. While the cost appears as a tax, employees undoubtedly get much more for their money than they did when they tried to provide individually for their security.

State revenue systems

Each of our forty-eight states has its own revenue system, yet certain generalizations may be made. The states do not of course raise any revenues by customs duties, and they receive far less than the federal government from income and death taxes and from liquor and tobacco taxes. State expenditures are met largely from general property taxes, sales taxes, gasoline taxes, motor vehicle taxes, income taxes, pay-roll taxes which supplement the federal pay-roll taxes for security, business taxes, and to a small extent from inheritance taxes, poll taxes, and miscellaneous taxes. General property taxes will be considered under local government revenues, but the others call for brief consideration here.

Sales taxes. Of the various types of sales taxes, we can consider here only those imposed on retail sales. Little known twenty years ago, they have swept over this country and many others with amazing rapidity, a result largely of the depression and the decline in revenues from other sources, and of the people's unwillingness to raise the taxes on property, incomes, or other sources of revenue. Today sales taxes are levied in more than half our states, and in 1944 they yielded over 2 billion dollars, or about 40 per cent of the state revenues. To prevent people from buying in adjacent states which may have no sales tax, many states levy use taxes on goods brought into the state. The sales tax has certain modest virtues. It is highly productive; it is paid without much grumbling; and, since it falls on all, it probably has some value as a reminder that the costs of government must be paid and should therefore be kept within reasonable limits. Since town and city people buy a greater proportion of their commodities than farmers, the sales tax helps to balance the general property tax, which bears more heavily on farmers. On the other hand, the sales tax has notorious vices. It is rather heavily regressive. With a 3 per cent sales tax, a man with an income of $1000 pays twice as high a rate as a man whose income ranges from $10,000 to $25,000, and four times as high a rate as the man with an income of $100,000. It is troublesome and expensive to collect, particularly if tokens are used in making change. This trouble and expense would be greatly reduced if the tax were imposed directly on the merchants on the basis of gross sales. Presumably merchants would shift most of it to the consumers, and the cost of collection would be less.

The wisdom of imposing a sales tax depends on economic circumstances. In a time of depression, when most of the people lack the purchasing power to buy the goods that *must* be produced if there is to be full employment, it is gross folly to reduce their purchasing power further by imposing a sales tax, for this inevitably makes the depression worse. In a period of roaring war prosperity, on the other hand, when prices are rising in an inflationary spiral, a sales tax may well serve the useful function of soaking up some of the excess purchasing power and forcing the people to buy less, in addition to raising considerable revenues. It would not prevent prices from rising, but on the contrary would cause a greater rise, for retailers would generally add the tax to their customary prices; but the price increase would go to the government for war expenses, and higher prices would help to adjust the demand for goods to the reduced wartime supply. Although a nation-wide sales tax would have these great virtues during a period of war prosperity, President F. D. Roosevelt refused to approve it, perhaps for fear that it would be difficult to abolish it later.

Gasoline taxes. With the growing motorization of American life, gasoline taxes have come to occupy an important place in state tax systems; nearly 691 millions was obtained from this source in 1944. Although the oil and automobile companies have fought them vigorously, they have risen steadily, until today the state tax averages 4 cents a gallon (plus 2 cents federal tax), and in several states it is 7 cents. It is about as popular as any tax can be, and if the revenues are used in road construction and maintenance, it is sound from an economic point of view. It is consonant with the benefit theory of apportionment, because the amount of gasoline consumed is a fair measure of the benefit received from the use of the highways. The great economy in driving on good roads is an important reason why the tax rate has been raised so fast and why highways have been built at such an extraordinary pace in recent years; a gasoline tax costs less than car repairs. Since these revenues have been used largely in building good roads, they have undoubtedly increased both gasoline and automobile sales.

Motor vehicle license taxes. Motor vehicle license taxes may well be considered here because they supplement the gasoline tax and yield nearly half as much revenue as that highly productive tax. As payment for the privilege of using the highways, the gasoline tax functions well and equitably; but as payment for the wear and tear incident to this use, it is not entirely satisfactory. Heavy trucks and busses damage paved highways far more than in proportion to their gasoline consumption, and they may well pay heavy license taxes to help to cover such wear. Licenses are required for all motor vehicles, however; in most states the tax is graduated somewhat according to the weight of the car, as a concession to the principle of ability to pay.

State income taxes. Income taxes are levied in most of the states, but no state tax is as steeply progressive as the federal tax, and in a few states the tax is proportional. State income taxes present difficult problems as to jurisdiction and administration. They represent double taxation, for the income is taxed by the federal government and in some cases by other states as well. They also present a problem of migration of both individuals and industries. Wealthy people may avoid the states which levy heavy personal income taxes; and it has often been claimed that state corporation income taxes drive productive enterprises into other states, but this charge has never been substantiated. Every state must meet its expenses in one way or another, and the revenues brought in by corporation income taxes do not have to be raised by any other tax. In spite of all difficulties, income taxes are likely to remain part of our state revenue systems.

Other state taxes. The other state taxes do not call for much discussion. State pay-roll taxes are supplementary to the federal pay-roll taxes and are used to finance social security benefits; in some states they constitute a considerable burden. Business taxes are of various kinds, such as license fees for engaging in certain businesses or professions. State death taxes generally take the form of inheritance rather than estate taxes. Poll taxes are atavistic survivals from ancient times, regressive, unproductive, and hard to collect; but they are used, particularly in certain southern states, as a means of preventing the lower classes from voting.

Local taxes

The general property tax. The general property tax is "the backbone of the 'state and local' revenue system in the United States."[7] Groves defines it as "a tax upon all wealth, tangible and intangible, which possesses exchange value," and theoretically it is assessed at the same rate on all property within the taxing jurisdiction. This definition will serve well enough, although in most states the tax has been amended to exempt certain kinds of property or to apply different rates. This tax is thus not as general as it once was.

Prior to the Second World War it produced more than 4 billion dollars, or about a third of all tax revenues and two-thirds of the state and local revenues. With the rapid increase in government expenditures over the past few decades, the rates have been raised drastically, until today the tax takes a large part, and in a few jurisdictions all, of the income from some real property. The rate in some towns is as high as 4 or 5 per cent on the assessed value of property which in many cases does not yield enough income to pay the tax; and during the depression the rate on millions of acres of poor farm land was so high that some landowners turned their holdings over to the state.

The general property tax has been criticized severely by most tax experts on the grounds of both theoretical assumptions and administration. The tax rests on the assumption that for taxing purposes all property is equally able to pay taxes. A factory, a residence, a mortgage, a bond, a piano, and a tract of standing timber are thus assumed to be equally able to stand the tax. But this assumption is clearly invalid. The factory may well produce an income; the residence is used as a home, a consumers' good; the mortgage yields an income, but it stands against property on which a tax is already being paid, and it can be taken to another state; the bond may be secured by a mortgage on property already taxed, and it

[7] Harold M. Groves, *Financing Government*, p. 54.

can be easily hidden or taken into another state; the piano is a consumers' good; the standing timber may not be ready to cut for fifty years, and will presumably yield no income until cut.

A second assumption, that ownership of property is a good measure of the ability to pay taxes, is only partly valid. It was to some extent valid a hundred years ago, when most people were farmers and physical property was the chief form of wealth; but today tangible property is relatively much less important than it once was, property rights are vastly more complicated and diffused, and the income from which taxes must be paid is received for the most part from other sources than the ownership and use of property. It is conceivable that the general property tax might cost a farmer with a cash income of $500 a year as much as one-fourth of the rent of his farm, whereas a corporation president with an income of $100,000 might pay the tax only on his residence and tangible personal property. Peanut vendors with an investment of around $100 have been known to make larger incomes than farmers with $10,000 invested in land, and lawyers and doctors earning large incomes may pay taxes on only a few thousand dollars' worth of professional equipment. Property ownership is by no means an accurate indicator of taxpaying ability.

A third assumption underlying the general property tax, that all property can be found by the assessor, is likewise invalid. A growing proportion of our property is intangible, in the form of mortgages, stocks, bonds, and other paper claims, some of which can be hidden from the assessor with little risk of detection. In jurisdictions where such intangibles are taxed at the general property rate they are seldom listed by their owners; but in states which once taxed them thus, and later exempted them or subjected them to a merely nominal rate, they have appeared on the tax rolls in large numbers, like birds in the springtime. Intangibles are not the only property that the assessors do not find. From the assessment records it often appears that gold watches and jewelry are rare or quite unknown, that most automobiles are junk, that the furniture and rugs, even of the rich and well-to-do, are in a sad state of obsolescence, depreciation, and dilapidation. If lying to the assessor is a sin, the general property tax bears the responsibility for an extraordinarily widespread disintegration of public morals.

The general property tax is worse from the standpoint of practical administration than of theory, for in most states it is badly administered. The assessors are local men, city or county officers, generally honest and fairly competent, but entirely untrained for this work; and in some cases they are personal friends of some of the people whose property they have to assess. Rather generally they assess property far below its real value, although the underassessment varies widely among different properties and localities. In most states the administration of the tax is improving, but it is not yet very good.

Why do our states retain a tax which is so generally condemned? In the first place, because it yields heavily, and the states would be hard pressed to find an equally productive source of revenue. In the second place, because it is well adapted to home rule, and many people, perhaps with some reason, are distrustful of too much centralization of government. In the third place, because it has the virtue of being an old tax. Property values have become adjusted to it, most owners have bought their property at prices which capitalized it, and to abandon it would amount to dropping an unearned value increment into their laps. Finally, even though it is a bad tax in many ways, there is no certainty that if it were abandoned a better tax would be put in its place. To increase the sales tax to fill the breach, for example, would hardly be an improvement. If there is a shift from the general property tax, it should be made gradually.

PUBLIC DEBTS

Public loans

In ordinary times taxes should equal expenditures; but during extraordinary crises, governments often secure part of their revenues by borrowing, with the result that debts —federal, state, and local—have generally tended upward, particularly in recent years. The total net debts in 1941 were as follows:

Federal	$48,653,000,000
State	1,544,000,000
Local	14,470,000,000

The federal debt

Federal debt figures prior to the First World War look petty and inconsequential today. The debt of 127 million dollars incurred in the Revolution and the War of 1812 was almost entirely paid off by 1836, and later deficits brought the total up to only 64 million before the Civil War. That war raised the federal debt to what was considered a back-breaking total of nearly 3 billions, but this had declined to less than a billion in 1893; it rose to a little over a billion before the First World War in 1917. The war brought the debt up above 25 billions, but in the generally prosperous years following the war it was reduced to 16 billions by 1930. The Great Depression brought heavy federal deficits because of curtailed revenues and extraordinary expenditures for relief and pump priming, and by 1934 the debt had reached a new record of 27 billions; it was up another 10 billion by 1938, and another 10 billion by 1941, before we entered the Second World War. In 1942 it stood at 58 billion dollars, and in July, 1945, it had reached 268 billions and was still rising rapidly.

State and local debts

State and local debts have not grown as rapidly in recent years as the federal debt, partly because the federal government assumed a major share of the burden of relief. Between 1912 and 1940, the gross debts of our states increased from $422,797,000 to $3,526,407,000; and the gross debts of the local governments, including cities, from $2,075,152,000 to $16,719,684,000.

Public debts have been growing not only absolutely but also relatively to the national wealth. According to a study made by the Twentieth Century Fund, the ratio between total government net debt and the national wealth rose from a little more than 3 per cent in 1890 to nearly 17 per cent in 1936; and in 1945 it was about 50 per cent.

Conditions justifying borrowing

Public borrowing may be justified under certain circumstances. To meet the expenses of widespread disasters, such as the devastating Mississippi River flood of 1927 or the great drought of 1934, the government may well borrow rather than raise the tax rate suddenly. If we include severe depressions among such great disasters, the cost of relief may properly be met by borrowing, but with the clear understanding that the borrowed money shall be repaid when prosperity returns. A severe depression would be intensified if attempts were made to balance the budget either by raising tax rates drastically or by reducing government expenditures. Carver has suggested that the gyrations of the business cycle may be lessened by borrowing in periods of depression and paying debts in periods of prosperity. This is certainly a sound policy if the people would submit to heavy taxation in prosperous times; but they just do not like to pay taxes at any time, although their record, until recently, has been fairly good.

It may be justifiable too for the government to finance productive enterprises, such as Boulder Dam, by borrowing, since they will presumably provide revenues for the repayment of the loans; and the government may well borrow to build needed public improvements in times of depression; in fact, its building should be done largely in such periods, but the wages it pays must not be so high as to draw labor away from private construction and discourage private enterprise. In ordinary times, and even more emphatically in periods of prosperity, the government should be cautious about borrowing for non-productive enterprises, particularly those which will involve continual expense for maintenance. Borrowing for such purposes saddles the taxpayers with two future burdens, the interest on the bonds and the maintenance costs. If such enterprises are actually needed and are worth the money, borrowing may perhaps be justified; but many cities and states have found that money borrowed in time of prosperity and paid back in the inevitable later depression is repaid at very great cost.

The theory of public debts is too complicated for detailed discussion here, but three important principles must be considered briefly. In the first place, public debts are not like private debts. When an individual borrows, he is in debt to someone else; he is poorer by the amount of the debt. This would also be true of a nation or a state if it borrowed from another nation or state. But if a government borrows from its own people, the country is no poorer than before. This does not mean that the amount of the public debt is of no consequence. If every taxpayer owned government bonds in strict proportion to his tax payments, the debt would indeed be a matter of little importance, and the government could wipe out the whole amount without any injustice; but unfortunately the taxpayers and the bondholders are largely different classes, and therefore the debt may present very serious fiscal problems. Payment of the interest and of the debt itself may put a serious burden on some taxpayers—those who do not own bonds.

In opposition to this reasoning, a number of economists have publicized the theory that public debts are nothing to be concerned about if they are owed to the people within the country; that in a depression the debt can be piled up almost indefinitely for the construction of worth-while public improvements, with a consequent increase in the nation's wealth. This is true as a general proposition, as we can see from a little hypothetical national bookkeeping, artificially simple.

Let us suppose, first, that the federal government, during the great depression from 1929 to 1939, balanced its budget, but that, owing to the great amount of unemployment, the wealth of our country did not increase at all. In this case there would have been no increase in the debt. The country would each year have wasted, as it actually did waste, about 20 billion dollars in wealth as the result of unemployment, but the public debt would not have increased.

Now let us suppose that, instead of balancing the budget, the government had borrowed 20 billions each year to put unemployed labor and capital to work, adding 20 billions to the debt, but adding also 20 billions in productive wealth each year, and of course 20 billions in the bonds bought by the people. At the end of ten years the country's physical wealth would have increased 200 billions, the debt would have increased 200 billions, and the bonds, which stand as assets against the debt, would have increased 200 billions. Since the bonds would exactly balance the debt, the country would simply be 200 billion dollars richer, because the government had borrowed money to put the unemployed to work instead of balancing the budget and wasting 200 billions' worth of productive labor and capital. This policy could be continued indefinitely, with a steady enrichment of the nation and a steady rise in the standard of living. It is true that the management of so large a debt would be difficult; but the waste of 200 billions in productive wealth is a national calamity, and if there is no other way of putting the labor and capital to work, the debt should be incurred.

But suppose that the government, instead of building 20 billions' worth of productive wealth each year, produced 20 billions' worth of consumers' goods. Clearly the case for borrowing would not be so strong. The people would be able to live better, would be able to consume 20 billions more in goods each year, and the bonds, as before, would balance the debt; but since productive wealth would not be increasing, the debt would be less manageable than it would be in a country whose productive wealth is growing.

It is commonly believed, as a second principle, that borrowing is a means of throwing the costs of government onto future generations; but this is a completely false notion, if the government borrows from its own people. If the government could borrow from another country, it might indeed do that. Future generations would have to pay the bonds, or at any rate the interest on them, and would not receive these payments or interest; but when a government borrows from its own people, the next generation inherits the debt and an equal amount in bonds. Certain individuals of the next generation pay to certain other individuals of the same generation the amount of the debt, but they can pay nothing to the present generation.

This principle may deserve a little more careful scrutiny. Suppose that when labor and capital are fully employed in private production the government decides to borrow money and build a new highway. The present generation has the highway but it does not have the wealth, let us say in the form of new houses, that would have been produced by the labor and capital if the government had not built the highway. The wealth of the present generation is about the same as if the government had not built the highway. The future generation too is in roughly the same position. It inherits the highway instead of houses, and it inherits a debt and an equivalent of bonds. Who pays for the highway? In a sense, both present and future generations do, because the houses that would have been built are durable goods, like the highway, and both present and future generations have lost the use of the houses in order to have the highway.

If, however, the labor and capital used in building the highway would otherwise have been used to produce non-durable consumers' goods—gasoline, whisky, beefsteak, and shoes—and if we ignore the fact that the present generation will use the highway for a while and assume that the road will last indefinitely, then the present generation pays the entire bill—pays in the sense of foregoing consumption, for it denies itself consumers' satisfactions equal to the cost of the highway—and future generations gain by the value of the highway. They inherit the highway and the debt and the bonds; since the debt and the bonds cancel each other, the people are ahead by the value of the highway. They are quite as well off as if the present generation had raised the money by taxation; they may be even better off, because if the present generation had done this, it might have got some of the taxes from men who otherwise would have devoted this money to the production of durable goods, and so it might have reduced the future generation's inheritance of durable wealth.

But suppose that in a time of depression the government borrows money from its people to build permanent improvements, needed school buildings for example. Here it does not need to take labor and capital from private production; it uses the labor and capital which would otherwise have been unemployed, wasted. The present generation loses nothing in goods, and future generations have the schools, the debt, and the bonds. The latter two cancel each other, and future generations are richer by the value of the school buildings. To the extent that such great public enterprises as Boulder Dam, Grand Coulee Dam, Bonneville Dam, and the Tennessee Valley Authority were built during depression times by labor and capital which would otherwise have been wasted, they cost our generation nothing, and added to the wealth of future generations by the extent of their value.

All this leads to a third principle of importance. In an economy in which there is full employment, the real cost of a public improvement—or of a war—to the present generation is the same whether it is paid for by current taxation or by borrowing. The real cost is represented by the goods which the people must go without in order to have the improvement or the war; and this cost is the same whether the money is secured by taxation or by bonds. Other production must be reduced by the amount necessary to allow the production of the improvement or of the war materials. Fundamentally this is the cost that is involved. This will come up again later in our consideration of war economics.

QUESTIONS

1. What are some of the reasons for the general rise in the expenses of government over the past century, aside from war?
2. Why have federal expenditures risen more rapidly than those of the states?
3. Why do modern wars cost so heavily?
4. How would you describe, in a general way, the purpose of state and local expenditures?
5. Are the goods and services provided by the government generally inferior to those bought by individuals privately? Explain fully. In what general respects are they different?
6. What commercial enterprises are operated by the federal, state, and local governments? Are they usually operated for profit?
7. Name some of the resources that are included in the public domain. For what general purpose is the domain retained by the government? Would not private industry "develop" the resources more rapidly?
8. Secretary Albert Fall was sent to the penitentiary for trying to turn the naval reserves over to private oil companies to develop. Was he not trying to encourage "private enterprise"?

9. Distinguish between the pure financial and the politico-social conception of taxation. With taxes as heavy as they are now, can we fail to use the latter?
10. Define regressive, proportional, and progressive taxes, and give illustrations of each. What are the arguments for and against progressive taxation?
11. What are the requirements of a sound tax system? Discuss each one.
12. Draw a graph to show the process of shifting, if any, of a tax imposed on a monopoly (a) per unit of product, and (b) fixed.
13. Why cannot a tax on land be shifted? On what theory would you assume that a heavy personal income tax might not be shifted?
14. Describe some ways of evading the personal income tax.
15. Explain why the tariff is about the worst of all taxes.
16. Why is a sales tax very bad in a time of depression? Why might it be fairly good during a period of war inflation?
17. What are some of the vices of the general property tax? Why is it retained?
18. "If the government borrows money from its own people in a time of depression to create useful wealth, the wealth created is a net addition to the wealth of the nation, and it costs the people nothing." Do you agree? Why or why not?

Part VI

GENERAL ASPECTS OF CAPITALISM

Chapter 34.

The Machine Age

We have now completed our study of the capitalist system as it is analyzed by most economists. It seems pertinent to proceed further, however, and make a brief appraisal of the system, to consider some of the reasons why it is being amended or abandoned in some countries, and what possible alternative systems there are. But before taking up these subjects, it may be worth while to consider one of the most significant aspects of our modern economy, its use of machines—we might even say its domination by machines, for ours is indeed a machine age, and many of our most critical economic problems arise from the remorseless spread of the machine technology.

Technology defined

In defining the term technology we cannot do better than to use the definition given by Theodore Kreps:

> The term "technology" in its narrowest sense refers to changes in technical processes, the machinery, the plant, and equipment used by businessmen to manufacture and distribute their product. In the typical instance such changes increase the product per man-hour of labor or improve the quality. But there have been many increases in productivity due to factors other than changes in mechanical apparatus, notably improvements due to scientific management regularizing the flow of production, lowering costs, and the like. A change in floor plan providing a more even flow of raw materials, standardization of materials, a faster or more even flow of farm, factory, and mining products to markets, reducing inventories and lowering the cost of warehousing, improved factory lay-out and machine assembly, economies in the use of power, better selection of personnel with reduction of labor turn-over, time and motion studies reducing the effort required by labor to do specific tasks—all those come under the general heading of technology.[1]

In this chapter we shall devote our attention largely to machines and to some of the scientific developments that have accompanied the advance in machine construction and the use of power.

The machine age

It is impossible to set any particular date as the beginning of the machine age. What is usually called the Industrial Revolution occurred during the latter part of the eighteenth and the first part of the nineteenth century, but there were machines and factories before this. During the nineteenth century a rather steady increase in mechanization took place, particularly rapid after the Civil War, and even more so after the First World War. In recent years we have been passing through an industrial revolution more dynamic than that which occurred in the eighteenth century, "a revolution that strikes more deeply, falls upon a wider front and a more complicated industrial system, than did its progenitor of 150 years ago."[2]

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[1] Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16211.

[2] Frederick Mills, in *ibid.*, p. 16246.

The ubiquitous machine

We have developed a myriad of machines of every size and kind: gigantic steel planing machines that weigh half a million pounds and are capable of finishing the four edges and one face of a piece of armor plate 12 feet wide, 24 feet long, and 12 inches thick at one setting; great lathes for turning cannons and huge steel castings; drilling machines as large as an ordinary dwelling house; engines, dynamos, and turbines; steam platen presses capable of applying a pressure of 20,000,000 pounds. At the other extreme are the tiny machines used in watch factories, which work at high speed and with almost miraculous accuracy. In recent years there has been rapid progress in developing machines of greater size, accuracy, and rigidity, of faster speeds and larger output.

Not only has productive capital piled up in the factories; in the form of machines of all kinds it has invaded the farm, the workshop, and the home. A century ago the farmer, even in the United States, had only a few simple implements—a plow, a wooden harrow, and perhaps a small horse rake—that were grossly inefficient by any modern standard. Practically all the other farm implements, such as the scythe and the cradle, were hand tools. The year 1850 marks the beginning of modern agricultural machinery, and the pioneer who homesteaded the land of the Middle West in the 'sixties and 'seventies had a few more implements: a mower, a cultivator, and perhaps a harvester which did not bind the sheaves but only dropped the grain in piles. With the coming of the tractor and combine about the time of the First World War, agriculture entered a new machine age which was to change the farm economy and farm life and raise many perplexing problems which are still unsolved. Today a well-equipped farm in the Middle West must have a large number of efficient and expensive implements.

The machine is revolutionizing the shop too. The old blacksmith shop where the sturdy smith shod horses and hammered out plow lays has been superseded by the machine shop with a number of efficient and expensive machines. The carpenter's shop may have motor-driven saws, planes, and drills, infinitely faster and more accurate than the hand tools with which the carpenter used to work. The cobbler with his few simple tools has given way to the modern shoe repair man, who works mostly with motor-driven machines.

In some of the professions the same transformation has taken place. The optometrist of even a generation ago had only a few simple instruments costing less than $200; an up-to-date shop today has at least $1200 worth of complicated instruments, and the equipment in the best shops represents an investment of several thousand dollars. The doctor's office and the hospital room in which he works are now equipped with a number of expensive machines; and the doctor must be a technician of no mean talent to operate them all—some physicians even have technical assistants to help them. Some of the instruments used in diagnosis and in operations are marvels of mechanical ingenuity.

The machine and the home

The machine is remaking the home in various ways, for it has taken out of the home many functions once carried on there. Only two or three generations ago, the housewife made most of the clothing for herself and her family, at first by hand, and later with a sewing machine. She baked bread, made butter, dried apples and corn for winter, made lye from ashes and used it in making soap, filled bed ticks with straw or husks, made "coffee" of browned rye or wheat, rugs of twisted corn husks, candles of tallow, dyes from walnut shells. She did her own washing and ironing, of course. Her husband raised his own meat supply, did his own butchering, smoked the hams in the smoke house, made his own sausage, shelled corn with a hand sheller or by hand, cut the wood for his stove with a saw and axe, put up his own supply of ice in the winter, and perhaps made many of his own medicines, from coal oil, turpentine, goose grease, skunk oil, honey, and various combinations of these.

Now many of these functions have been transferred from the home to the factory where they are performed with the aid of machines: baking, churning, sewing, butchering, canning, soap making, and many other tasks. The work that is left to the home is being taken over by machines too, largely electric machines—refrigerators, peelers, slicers, choppers, mixers, vacuum cleaners, fans, dish-washers, percolators, waffle irons, toasters, razors, pressing irons, curling irons, water heaters, furnace stokers or oil or gas burners, electric lamps to simulate sunshine, electric exercisers to relieve lazy, fat people of the necessity of exerting themselves, and in a few farm homes pumps to bring water into the house.[3]

Increasing use of power

With the growth in productive capital has gone an even more rapid increase in the use of power. The first source of power was human muscle; and a puny force it was, in the night-black ignorance of the time, against the heavy resistance of nature. The total output of goods was so small that only a few could live even tolerably well, by exploiting an army of slaves. In Greece, the most democratic of ancient states, there were five times as many slaves as free men. Next, and of particular importance in the agricultural stage, came power from domesticated animals—the ox, camel, horse, mule, and in some places other animals—which greatly lightened the burden on human muscles and expanded the product of human labor. Water power, well understood by the Egyptians, Assyrians, and Persians, was used in irrigation enterprises, and wind power was harnessed to propel ships; but for several thousand years there was little further development in the science of power production or in the use of power.[4]

With the invention of the steam engine in the eighteenth century the "steam age" was ushered in. The crude and rudimentary engine made by Watt was improved by later inventors and technicians until the powerful reciprocating engine, capable of driving miles of shafting in factories, was developed. Prior to 1880, the only important source of power was the steam-driven reciprocating engine, which, although it had brought a great development of machinery, imposed rigid limitations on the types and efficiency of machines and on factory organization. Between 1880 and 1890 the steam turbine was developed, and following it the internal combustion engine using gasoline, kerosene, or fuel oil. The steam turbine has several advantages over the reciprocating engine. In the first place, it is capable of developing vastly greater power. The rate of improvement in turbines in recent years has been almost magical. Even as late as 1920, the largest unit possible was thought to be about 40,000 horsepower, yet twelve years later one was built that had a capacity of 200,000 horsepower—more power than could have been exerted by all the men and women in the United States in Washington's time. In the second place, the turbine is smaller, much lighter in weight, more economical in fuel consumption, and capable of developing higher speeds and higher pressures. The weight and floor space required by the larger turbines is less than one-fifth what it was thirty-five years ago.

In the internal combustion engine, particularly in the automobile engine, size and power have been stressed less than lightness; yet gas engines are made that generate 8000 horsepower, and some Diesel engines generate more than 15,000 horsepower, using fuel oil with extraordinary economy. A Union Pacific streamlined train pulled by a Diesel engine traveled 3260 miles across the continent at a fuel cost of less than 2.5 cents per mile. The internal combustion engine is far more economical of fuel than the reciprocating engine could possibly be made, and some technicians believe that when our oil approaches exhaustion coal will be liquefied and used in internal combustion engines rather than in boilers to produce steam.

Increase in the power used on farms has come largely from the use of internal combustion engines. The figures from 1850 to 1930 are given on page 506. Today (1946) this figure is nearly 120,000,000 horsepower.

Electricity

But the power age would never have reached full bloom without electricity. As early as 1821, Michael Faraday discovered the secret of the interchangeability of electrical and mechanical power and after years of experimentation developed the dynamo, which in succeeding generations laid the foundation for the creation of important industries for the production of mechanical and electrical energy in volume sufficient for very large industries. Further inventions relating to the transformation and transmission of energy greatly expanded the range of the earlier appliances, and a new power age—the electrical age—was inaugurated. Steam power was not discarded but was turned into electricity. Today electric motors totaling more than 35,000,000 horsepower turn most of the wheels of industry.

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[3] For further information as to the increase in household machines, see Harry Jerome, *Mechanization in Industry*, pp. 173–177.

[4] On the development of power, see Hugh Quigley's article in *Encyclopaedia of the Social Sciences*, vol. xii, pp. 293 ff.

Total Horsepower Used on Farms[5]

1850	6,494,000
1860	9,437,000
1870	9,379,000
1880	14,087,000
1890	20,347,000
1900	22,997,000
1910	27,928,000
1920	37,495,000
1930	70,502,000

Most of the energy developed by the engines used in industry—76 per cent in the United States—is applied not directly but through electricity. This gives flexibility, power, speed, precision, freedom of movement, and ease of control in industrial operations. It is no longer necessary to hitch machines in rows along transmission shafts to get power, and the maze of belts that formerly obscured light and endangered the lives of employees has been largely eliminated. Machines can be moved anywhere and so placed that material can flow from one to another with a minimum of moving about. In plants which have a variety of machines, some of them in use only part of the time, there is convenience and economy in providing each machine with its own motor. Finally, the electric motor affords speed and steadiness impossible to achieve with mechanical connections. In some rayon plants, for instance, each spindle has a small motor, with a speed of 9000 revolutions per minute, so free from vibration that the delicate yarn is not damaged. More than 100,000 such individual motors have been installed by the rayon industry in the past fifteen years. Because of the various advantages of electrical power, the amount used increased from 43 billion kilowatt hours in 1920 to 168 billion in 1941.

Electricity is thus a revolutionary factor. As Walter Polakov says: "What is it about electrical power which has enabled it to play its stupendous role in human affairs? Briefly, it *is power devoid of bulk—energy available at any time in any quantity—without storage*—energy, furthermore, which is applicable in many forms. This flexibility and ease of control are the qualities which have made electricity the vitalizing, all-pervading force which has revolutionized not only industry but all our living."[6]

Transportation agencies have been much slower than industrial plants to adopt electricity, largely because the expense is so great. Railroad electrification has proceeded on a large scale in some European countries and in New Zealand, but not in England or the United States. In marine transportation the tendency is toward the use of electricity with the reciprocating steam engine or turbine.

But electricity is employed for more intricate tasks than this. To an increasing extent it is used in the *control* of industrial operations. In a steel-plate mill, for instance, the product is never touched by human hand; it is controlled from beginning to end by electrical devices, even to inspection with X-rays and the electric eye. The size, thickness, quality, and color of the product are tested not by the trained eye of the skilled artisan but by an electrical device which is more accurate and of course untiring; however, the skill of man cannot be dispensed with, for these electric devices must be controlled by a skilled technician capable of sustained attention, correct perception, and prompt reaction.[7]

An interesting summary of the important functions of the photoelectric cell is offered by C. C. Furnas in his book, *The Next Hundred Years*:

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[5] From the Report of the Federal Trade Commission on the Agricultural Implement and Machinery Industry, 1938, pp. 99, 100.

[6] Robert Morss Lovett and others, *Recovery Through Revolution*, p. 421.

[7] See Walter N. Polakov, *The Power Age*, and also an article by him in *New Republic*, January 4, 1933, p. 204.

The photo-electric cell, or electric-eye as the popularizers like to call it, can be made as sensitive as the human eye. It cannot be imbued with brains, but it can be adjusted (trained if you like) to perform routine tasks, reliably, consistently, cheaply. Suppose you are wrapping candy bars by machine. If you are making candy bars you would not think of doing it any other way. The wrapping machine probably moves so rapidly that you cannot follow its motion with the unaided eye; so, as might be expected, it missteps occasionally and omits a wrapper. Girl inspectors might be counted upon to catch such omissions but a photo-electric cell is better. It never fails to see the missing wrapper. Photo-cells never get sleepy, no matter how late they have been up the night before. By keeping the bars moving down a belt conveyor, and keeping them separated one from the other, the photo-cell equipment will accurately and mercilessly throw off every uncovered specimen.

Similar equipment sorts beans or cigars on the basis of color. Photo-cells can judge the color of textiles more accurately than can the human eye. They are being used to maintain lubricating oil at a given color and coffee at a uniform strength. Temperature is very important in the heat treatment of steel bars and electric-eyes are being used to remove bars from reheating furnaces as soon as they reach the desired degree of redness. They are being used to guard prison walls and safes. By causing a bell to ring they warn a fireman when he is creating a smoke nuisance. They are used to regulate the thickness of paper in its manufacture and to stop the machinery and give warning if the paper breaks. They automatically level elevators at floor stops. They sort cards for tabulating machines and a practical device is available for apprehending speeders on the highways. They are certain, accurate, and not susceptible to arguments or feminine beauty. At bridle-path crossings they operate traffic lights for horses but not for humans. The most common and simplest task of the cell is that of counting. They are used in factories to count almost every conceivable thing. The vehicles crossing the Ambassador Bridge at Detroit are so counted.[8]

A rather interesting example of the advance of science is seen in new methods of searching for oil—in geophysics. Twenty years ago, advertising any sort of "doodle bug" as a device for locating oil deposits was prohibited by the federal government as necessarily fraudulent, because it was assumed, and at the time correctly, that no such device was of any use. Since that time millions of dollars have been spent in the development of geophysical methods and devices, and through their use a number of oil pools have been discovered. Perhaps the new science will reveal not only oil deposits but deposits of the various metals, although in the latter field it has achieved only modest results.

The wonders of electrical science constitute a subject too vast and too difficult for this book. We need only mention the developments in electronics, in television, in radar, in a score of fields that are beyond the comprehension of a mere economist. Scientific advance was accelerated by World War II, and it is perhaps not too much to say that our scientists and technicians contributed as much as any other group toward winning it—through defeating the submarine and through the development of the atomic bomb, to mention only two cases. And there can be no doubt that the advance will continue.

The production of power, formerly subsidiary to the industries using it, has become, in the dominant form of electricity, a separate industry of gigantic size, representing, in the United States, a capital investment of more than 12 billion dollars, and ranking next to the railroads in capitalization.

Along with the development of electricity as a handmaiden to coal- and oil-produced power has gone a rapid growth of hydroelectric power. The world's water-power production more than tripled between 1913 and 1937, and the percentage of total power derived from water nearly tripled. It is estimated that it would take nearly 250,000,000 tons of coal to produce the power now produced from falling water. Development in the United States has been particularly rapid since the First World War, nearly doubling between 1920 and 1930. By 1941 nearly 19,000,000 horsepower had been installed. Estimates of the total potential water power in the United States run as high as 75,000,000 horsepower, but much of this could be developed only at great expense, and much of it is available in regions of the West where sparseness of population or lack of raw materials or other handicaps stand in the way of development in the near future.

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[8] C. C. Furnas, *The Next Hundred Years*, p. 207. By permission of Reynal & Hitchcock, Inc.

The rapid growth in the use of electric power is shown in the figures of the National Resources Committee (see table below).

Total power available

The total amount of power available in the United States in 1935 was estimated by this Committee as follows:

Power Available in the United States in 1935[9]
(Horsepower)

Electric central stations	44,670,000
Industrial power plants	20,133,000
Electric railway plants	2,500,000
Isolated non-industrial plants	1,500,000
Mines and quarries	2,750,000
Agricultural, prime movers	72,763,000
Automobiles, busses, trucks, and motorcycles	965,000,000
Airplanes	3,500,000
Locomotives	88,000,000
Marine	30,000,000
	1,230,816,000

These figures involve some exaggeration, for of course some of this power is used only part of the time. Automobiles, trucks, tractors, motorcycles, and airplanes are not and could not be operated all or even most of the time on the amount of fuel available. A statement that the total power represents "the equivalent of 400 human slaves for each of the 30 million families in the United States" is an exaggeration; perhaps even 200 slaves for each family would be too high. Nevertheless, it is true that these are "servants that require no food and feel nothing of the wear and tear and hopelessness of a servile life."[10]

Not all this phenomenal increase in power is devoted to producing goods. A large part of it is used in moving goods and people about, particularly in automobiles and trucks, and some has been employed in domestic uses. The average domestic consumption of electricity rose from 264 kilowatt hours in 1913 to 673 kilowatt hours in 1935. An important reason for this increase in domestic use has been the decline in the cost of electricity: from 25 cents per kilowatt hour in 1882, to 16.2 cents in 1902, and to 5.03 cents in 1935. The domestic consumer gets much more for his money than he did thirty or forty years ago.

Improvement in machines

Along with the increased use of power has gone a general increase in the accuracy, reliability, and durability of machines, often with a decrease in size. In efficiency, durability, and economy of operation, agricultural machines improved between 50 and 100 per cent in the period from 1910 to 1932, and they have of course improved still further since then. Automobiles have improved much more than this. Anyone who drove a car twenty or thirty years ago, when one of the commonest sights on the road was a stalled car with a helpless motorist peering under the hood, will have some idea of the improvement in automobile construction. Today's car often covers 50,000 miles with little or no repairs. Improvement in tires has been little less than a miracle; whereas twenty-five years ago ordinary tires were good for perhaps 3000 miles; today the best tires

Horsepower of Installed Capacity in Electric-Generating Stations[11]

Year	Steam Plants	Internal Combustion Engines	Water Power	Total
1902	1,394,395	12,181	438,472	1,845,048
1912	4,949,778	111,035	2,469,231	7,530,044
1922	14,171,222	302,995	5,822,018	20,296,235
1930	31,000,000	600,000	11,600,000	43,200,000
1935	32,000,000	670,000	12,000,000	44,670,000
[1941				56,000,000]

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[9] *Technological Trends and National Policy*, p. 249.

[10] See Robert R. Doane, *The Anatomy of American Wealth*, p. 68; and C. G. Gilbert and Joseph E. Pogue, *Power: Its Significance and Needs*, p. 7.

[11] *Technological Trends and National Policy*, p. 249. Authorities differ somewhat in their estimates, but the figures of the National Resources Committee are probably as good as any.

often roll 30,000 miles. Horsepower in steam locomotives, in proportion to weight, has doubled in the past twenty years, with "higher boiler pressures, higher steam temperatures, greater fuel economy, greater steam capacity, better steam distribution, ability to make longer daily runs and greater mileage between shoppings."[12] The airplane of today is a vastly different machine from that of even three or four years ago.

Improvement in machines has been the result of many factors, one of which is the rapid advance in the science of metallurgy. There are now some 5000 different metal alloys, some of them much better than the metals formerly used. It has been claimed that the steel produced today wears nearly twice as long as most of the steel made fifty years ago. The advance has been phenomenal in some of the hard cutting metals. "A new material is now available which consists of a mixture of tungsten and titanium carbides cemented with cobalt. This is perfectly satisfactory for cutting steel and it has been found to have 60 times the life in operation that the original cemented tungsten carbide had."[13] "Through chromium plating the life of various tools and parts has been extended from 3 to 20 times. By the use of tungsten carbide, carboloy tools have been formed which operate in some cases 300 to 400 times as efficiently as the old steel tools. On a brass-plug job the number of finished pieces produced by old tools was 200, through the substitution of carboloy tools this was increased to 15,000."[14] Great improvements have been made in some articles through the use of the lighter metals and alloys, some of which are extremely strong as well as light; and some scientists believe that we are entering a new era in which steel will to some extent be displaced by these materials.

Increase in productivity

This phenomenal increase in the use of machines and power has brought a rapid increase in productivity. F. C. Mills has estimated that the output per wage earner in manufacturing increased 43 per cent in the decade between 1919 and 1929. David Weintraub puts the increase per man-hour in manufacturing between 1920 and 1929 at 48 per cent. According to Fabricant, between 1899 and 1940 the number of workers increased from an index of 100 to 190, but physical output increased from 100 to 429. With due allowance for the considerable shortening of the workday, this means a reduction in the "wage-earner hours" per unit of product from 100 to 30.[15] In some industries the increase has been much greater than this.

Fig. 44 shows graphically some of the developments in the machine age since 1850, with respect not only to labor output but also to capital invested, power employed, and length of workday.

A graphic contrast of ancient and present-day productivity is shown in the building of the Great Pyramid and the construction of Boulder Dam. The two structures have practically identical volumes, and Boulder Dam is much more complicated in design; yet according to historians, 100,000 men labored twenty years in building the Pyramid, whereas 1200 men built Boulder Dam in less than two years. The Pyramid cost 2,000,000 man-years, and the Dam 2400.[16]

In some instances the increased productivity has resulted largely from the higher speed of the machines. In the steel industry's continuous rolling mills which were introduced only a few years ago, steel strips move along at a rate of more than 20 miles per hour as they are flattened to the desired thickness. The speed of railroad trains is increased each decade. Between 1918 and 1937 the speed of freight trains increased 64 per cent, and this, with the larger freight cars and more powerful locomotives, more than doubled the "hourly output of transportation" per freight train.

As a result of the improvement in machines and of various other technological advances, our increased production since 1910 has been secured at a less than proportionate increase in investment in machinery. Between 1923–1924 and 1936–1937, the volume of output increased 25 per cent, whereas the fixed capital investment increased only 2 per cent. Thus the new technology saves in the use of capital;[17] and it saves also in the cost of labor, for in spite of a considerable rise in wage rates, labor costs per unit of product have generally declined.

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[12] Mary L. Fledderus and Mary Van Kleeck, *Technology and Livelihood*, p. 133.

[13] *Ibid.*, p. 46.

[14] Temporary National Economic Committee, *Hearings*, Pt. 30, p. 17300.

[15] Solomon Fabricant, *The Relation Between Factory Employment and Output Since 1899*, National Bureau of Economic Research, Occasional Paper No. 4.

[16] National Resources Committee, *Technological Trends and National Policy*, p. 381.

Obstacles to prompt introduction of machines

It should not be assumed that inventions and improved machines are always eagerly snapped up by industrial concerns and promptly put into operation. On the contrary, for various reasons they are often slow to find their way into the factories. In the first place, many people have a deeply rooted hostility to new and strange things. Most inventions, even the automobile and the airplane, at first faced strong popular incredulity or hostility. In the second place, many inventions have been opposed by the workers whose jobs might thus be endangered. In some early cases, inventions and new machines were destroyed and a few luckless inventors were killed. Even though labor never goes to such lengths today, strong unions are often able to delay the introduction of labor-saving machines. In the third place, producers of competing goods or services have often fought the introduction of new machines or processes in an effort to protect their own position. Manufacturers of hand- and foot-power sewing machines delayed the introduction of electric machines; producers of electric light bulbs fought the introduction of fluorescent lamps; newspapers tried in various ways to delay the broadcasting of news over the radio. In the fourth place, monopolies have

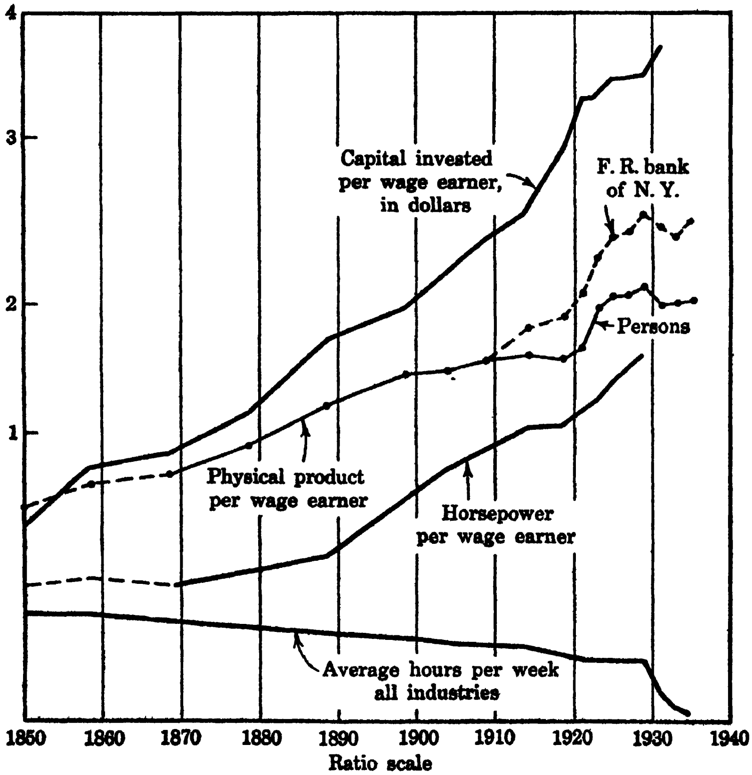

FIG. 44. Capital Invested, Horsepower, and Product, per Wage Earner in Manufacturing in the United States.[18]

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[17] Temporary National Economic Committee, *Monograph No. 37*, p. 99.

[18] From Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16223.

often delayed the introduction of new devices and processes by buying up and suppressing the patents. In the fifth place, most new inventions are crude, and their perfection may require further development along coordinate lines of technology or science. The early steam engines, for instance, could not be widely used until metals strong enough to stand boiler pressures were produced. And finally, businessmen often oppose new inventions which call for the scrapping of equipment already in use. The result of all this is that new inventions, devices, machines, and processes are often adopted by industry rather slowly, and technical progress outruns actual practice by periods varying from a year or two to a generation.[19]

Effects of machine technology

What have been the effects of the machine technology on labor, on the national economy, and on general conditions of life? Henry Ford sees in it not only the producer of goods for man's physical comfort and convenience, but the liberator of mankind from brutalizing drudgery: "The way to liberty, the way to equality of opportunity lies through power; the machine is only an incident. The function of the machine is to liberate man from brute burdens and release his energies to the building of his intellectual and spiritual powers for conquests in the fields of thought and higher action. Machinery is accomplishing in the world what man has failed to do by preaching, propaganda, or the written word—ushering in the United States of the World."

Nearly a century ago, on the other hand, John Stuart Mill wrote his famous polemic: "Hitherto it is questionable if all the mechanical inventions yet made have lightened the day's toil of any human being. They have enabled a greater population to live the same life of drudgery and imprisonment, and an increasing number of manufacturers and others to make fortunes." In these oft-quoted words, however, Mill was condemning not so much mechanical inventions as the trend toward overpopulation. A little later, John Ruskin raised a protesting voice against the growing mechanization of England: "A great cry rises from all our manufacturing cities, louder than their furnace blasts. . . . We manufacture everything there except men. We blanch cotton, and strengthen steel, and refine sugar, and shape pottery; but to brighten, to strengthen, to refine, or to form, a single living spirit, never enters into our estimate of advantages." Ruskin—painter, artist, and connoisseur—was outraged by the ugliness of the factory cities, the monotony of machine tending, and by what he considered the knavery and cheating of business. The productiveness of machine industry he rated of small worth, for according to him the simple life was best. In his ideal society, "no machines moved by artificial power are to be used on the estates of the society; wind, water and animal force are to be the only motive powers employed, and there is to be as little trade or importation as possible; the utmost simplicity of life, the restriction of possession, being combined with the highest attainable refinement of temper and thought." For many years Ruskin fulminated against factories and machines and he died a broken-hearted man because his protestations were of no avail; the factory system spread irresistibly over England and then over Europe. As Balzac said, "English inventions tend to mechanize other nations. England seems bent on seeing the whole world as dull as itself, and dull in the same way." In our own country, Thoreau challenged the machine and the industrial order because they denied to each person the right to live his own best life.

Oswald Spengler, the great German pessimist philosopher, saw grave menace in the machine: "But for that very reason Faustian man has become *the slave of his creation.* His number, and the arrangement of life as he lives it, have been driven by the machine on to a path where there is no standing still and no turning back. The peasant, the handworker, even the merchant, appear suddenly as inessential in comparison with the *three great figures that the Machine has bred and trained up in the cause of its development: the entrepreneur, the engineer, and the factory worker.*

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[19] For an interesting discussion of this subject, see National Resources Committee, *Technological Trends and National Policy,* Part I, Section IV.

Out of a quite small branch of manual work—namely, the preparation-economy—there has grown up (*in this one Culture alone*) a mighty tree that casts its shadow over all the other vocations—namely, *the economy of the machine industry*. It forces the entrepreneur not less than the workman to obedience. *Both* become slaves, and not masters, of the machine that now for the first time develops its devilish and occult power."[20] Spengler prophesied a time when man will "*blot out the whole thing from his memory and his environment*, and create about himself a wholly new world, in which nothing of this Devil's technique is left."

Technology a dominating force

We need not accept any of these extremes for the present, but we must concede that the technological process, as Stuart Chase says, "is perhaps the strongest force in the modern world. It threatens nations, constitutions, legal systems, property concepts, cherished beliefs and traditions, as well as jobs"; and the civilized world must either learn to understand and master it, or lapse back to some simpler form of society, or even barbarism.

For an example of the vast influence of just one machine, let us consider the automobile. This one machine nearly ruined many of our railroad and street railway companies, drove the horse and buggy from the economic landscape, built up the oil business to the status of one of our greatest industries, and brought the question of future oil reserves to the front as a problem of international importance. It demanded the building of a million miles of improved highways, incidentally raising the cement industry to first-rate importance; it made the rubber industry rank high in our economy, and bolstered the demand for steel, copper, leather, glass, and a score of other products, at the same time causing depression in the shoe industry. It remade our American cities, increased their size, scattered residences over vast suburban areas, reduced the average size of homes and the number of servants, dispersed retail centers, changed the nature of much of our hotel business, and dotted the landscape with tourist camps, road-side restaurants, beer joints, and night clubs. It destroyed hundreds of little towns with their schools and churches, brought in central school systems, enlarged county seats while making nine-tenths of our counties unnecessary, to some extent erased state lines, and created new problems of federal regulation. It introduced new opportunities for recreation and changed the character of recreational activities, raised the population of many recreational areas, and gave millions of people an opportunity to see scenic wonders formerly enjoyed by only a few; it increased our mobility, jarred people loose from their local provincialism, and in some cases even from certain established notions of morality; it bankrupted thousands of people of modest circumstances, and promoted a general spirit of extravagance. And it has killed more people each year than our Army lost in battle in the First World War. Ogburn may well not exaggerate much when he says that "the inventor of the automobile has had more influence on society than the combined exploits of Napoleon, Genghis Khan and Julius Caesar."[21]

The machine and labor

First, with respect to labor, it is safe to say that the development of machines and the resulting increase in productivity had much to do with the abolition of slavery and with giving human life a valuation it had never had before. When much of the power used had to be provided by puny human muscles, slaves could be and inevitably were used to the advantage of their masters; but the machine reduced the value of muscle power to a point where this form of human labor was unprofitable, nor could the machine itself be trusted to the apathetic attention of a slave. With the abolition of slavery, human life came to have a new value and dignity.

The machine, in the second place, has taken over much of the heavy, heart-wearing work of earlier days: lifting heavy burdens, scooping coal and grain, stoking engines, planing floors, sawing wood, mixing cement. For centuries there has been a continuous reduction in the proportion of the world's work that involves mere physical digging, pushing, pulling, lifting, carrying, hammering—the exertion of purely muscular force—and a continuous rise in the share of work falling to the scientists, architects, designers, engineers, toolmakers, accountants, clerks, statisticians, production managers, and salesmen.

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[20] Oswald Spengler, *The Decline of the West*, special ed., vol. ii, p. 504. By permission of Alfred A. Knopf, Inc., publishers.

[21] W. S. Ogburn, *Machines and Tomorrow's World*, Public Affairs Pamphlets No. 25; see also the statement by Theodore Kreps in Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16253.

In the third place, the machine has taken over many of the monotonous tasks of industry. Idealists often draw a depressing picture of the monotony of factory work: sewing tongues or setting eyes in shoes, turning Nut No. 40 on Ford cars hour after hour, day after day, week after week. Truly such routine work is not interesting or inspiring, and it may have a tendency to deaden the worker's initiative and enterprise; yet for various reasons the influence of the machine probably has not been as bad as is sometimes pictured.

For one thing, only a small proportion of our industrial labor is engaged in such routine work. Only about half our factory labor works directly with machines; only a total of perhaps 6,000,000 laborers, less than 5 per cent of the total population, can be classed as industrial "robots," and this percentage is declining as the machines take over more of the routine operations. When operations are reduced to routine, many of them can be handled by machines more cheaply than by hand. Furthermore, although a newly invented machine usually requires a great deal of care and attention, it gradually takes over the part of its tender's work which is routine and monotonous, leaving for him only the responsibility of seeing that the machine is in good order and is working smoothly.

The machine has thus taken over a great many wearing, monotonous tasks, the making of fine laces, for instance, which when made by hand eventually blinded some of the women who persisted in it too long, or the making of tiny screws for watches. As Marshall observed, the latter was done by operatives who acquired a high and specialized manual skill but who lived sedentary lives, strained their eyesight working with microscopes, and found in their work little scope for any faculty except command over the use of their fingers. The machine which makes these tiny screws "is intricate and costly, and the person who minds it must have an intelligence, and an energetic sense of responsibility, which go a long way towards making a fine character."[22] Marshall estimated that in the making of textiles, "for every hundred yards of cloth that are woven, the purely monotonous work done by human beings is probably not a twentieth part of what it was"; and there has been a further great reduction in this proportion since his time.[23]

There is indeed a great deal of routine work in the modern factory; but if it does not involve too much muscular strain, such work is not as distasteful to most people as it is sometimes assumed to be. Some laborers find it intolerably dreary and irksome. Stuart Chase cites the case of the girls of superior intelligence who were given monotonous cross-stitching to do; they developed speed very quickly but soon became so bored that their output declined below that of girls of average intelligence. Whatever the nature of their work, however, most people fall into a sort of routine when they can, because there is economy of mental effort in doing so; and many prefer routine work to that which calls for constant diligence and attention. Human beings have an extraordinary adaptability too, which enables them to adjust themselves to monotony or to other disagreeable characteristics of work. And finally, even in routine work there may be some zest in the speed and accuracy with which it can be done, and in the sense of power and competence which the machine gives the worker.

The broad effect of the machine on the skill required of workmen is a question about which much has been written but on which no positive answer has yet been given. The relative number of skilled craftsmen has declined, but the relative number of unskilled laborers has also declined. Differences in earnings of skilled and unskilled laborers are apparently less than they were thirty years ago. While the machine has made possible the use of much relatively unskilled labor, it has also created a demand for certain types of skilled labor, such as that required for making and repairing the machines. Jerome describes the total effect as "a leveling process producing fewer highly skilled jobs but also few really unskilled jobs."[24]

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[22] Alfred Marshall, *Principles of Economics*, pp. 257–258.

[23] *Ibid.*, p. 263.

Muscular strength and the old-time craft skill are thus less and less needed; but the workman increasingly needs the qualities of sustained attention, correct perception, and prompt reaction. As John Strachey says: "The worker is becoming more and more a *supervisor* of processes. Intelligence is coming into the factory; trade lines are vanishing, together with the old distinction between the 'white collar man' and the 'man in overalls.' Training for this kind of work may be given in a few weeks' time, contrasted to the years formerly spent in apprenticeship. The logic of the trend is the emancipation of the worker from the machine, rather than his enslavement by it.[25] This conclusion seems correct as to the *direct* effect of machine technology on the worker, but, as we shall presently see, it does not tell the whole truth; for indirectly machine technology drives us all, including the workers.

It is to the machine that credit must be given for the reduction in hours of work. But for the rising productivity of the machine, the workday could not have been reduced to the eight hours it is today. This shorter day has meant reduced strain, and time for rest and recreation. Even monotonous work can be endured if the hours are not too long, provided that there are time and opportunity for recreation. It is monotony of *life,* rather than monotony of work, that is to be deplored; and life is far less monotonous than it was before the advent of the machine.

The machine and unemployment

The rapid increase in productivity resulting from the spread of our machine technology is often said to be an important cause of unemployment, *technological unemployment,* as it is called. This is no new charge. One hundred years ago the preamble of the Mechanics' Union of Trade Associations of Philadelphia described that period as one "when wealth is so easily and abundantly created that the markets of the world are over-flowing with it, and when, in consequence thereof, and of the continual development and increase of Scientific Power, the demand for human labor is gradually and inevitably diminishing."[26]

Labor-saving machines have undoubtedly deprived many laborers of their jobs. Classic examples are found in the history of textile inventions early in the Industrial Revolution, when the invention and improvement, first of spinning and then of weaving machinery, threw the spinners and weavers alternately into utter destitution. Technological unemployment is a more serious problem in our present complicated capitalism than it was in the relatively simple economy of 180 years ago, for changes come at a faster pace, industry is more dynamic, and it is more difficult for workers to find new jobs.

In the long run, however, machine displacement of men in some industries creates an increased demand for labor in certain other lines of work. Laborers are needed in the mines to produce the raw materials for the machines in the factories to make the machines, in the railroads and truck companies to haul them, in the merchandising agencies to sell them. Thus the cheaper price of glassware resulting from the Owens automatic glass-blowing machine enabled consumers to buy more glassware, increasing freight and express business, wholesale and retail business, box making, and, more indirectly, the demand for space in retail stores and for all the materials and labor needed to provide this space in the stores. In this way machines, while displacing labor at one point, may provide jobs for other workmen over a wide field of industry; and by reducing costs they may reduce prices and in this way enable consumers to buy more of other products.[27]

This picture is entirely too cheerful, however. It is only moderately cheering to a jobless worker to know that the machine which took his job may create a job for someone else a thousand miles away, and that "in the long run" he will find a job himself, probably at lower wages and in work for which he is not trained. There is a considerable lag in the absorption of workers displaced by machines—about a year and a half, according to one estimate, if there is no complicating business depression; moreover, as long as technological advances follow each other rapidly, there is of course a persistent reserve of unemployed workers seeking jobs. A study of displaced Hartford rubber employees made by Dr. E. Wright Bakke revealed that during the first year the skilled workers lost 4.8 months of work, the unskilled 4.6 months. The annual income of the skilled workers fell to 50 per cent of their former earnings, and that of the unskilled workers to 62 per cent.[28]

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[24] Harry Jerome, *Mechanization in Industry,* pp. 63, 401.

[25] Robert Morss Lovett and others, *Recovery Through Revolution,* pp. 425–426.

[26] Henry S. Dennison, in American Economic Review, *Papers and Proceedings,* March, 1930, p. 142.

[27] An article maintaining that machine methods have actually increased employment appeared in *Iron Age,* March 10, 1932, pp. 595–99.

In general and in the long run, however, there will be no more and no less employment under one kind of technological conditions than under any other; for under any condition that remains constant for a long time, about all the laborers will "tend" to be employed. If we could halt technical and other changes for a few years and avoid business depressions, we should have substantially the same percentage of employment as if we had no machines. It is the *change* and not the *machines* that causes the trouble.

QUESTIONS

1. Indicate the changes that have been made in the home by the spread of machine technology.
2. Trace the historic developments in the use of power.
3. What are some of the revolutionary changes that have resulted from the use of electricity?
4. Increased production has been secured at a less than proportionate increase in the investment in machinery. What is the reason for this?
5. Trace some of the economic changes that have been brought by the automobile. Are they all good? Discuss.
6. In what ways has the machine improved the working and living conditions of laborers? In what way has it made his situation worse?
7. Why should we worry about technological unemployment, since all labor tends to be employed in the long run?
8. On the whole, do you think that the laborer of today is any better off than the one who lived before 1750? Make a comparison of their respective conditions, as regard longevity, standard of living, social status, security, independence, opportunity to rise, apprenticeship, mobility, education, efficiency. What are your conclusions as to the progress or deterioration of labor?

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[28] Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16222.

Chapter 35.

The Machine Age (*Continued*)

The machine and industrial organization

Turning now to the effects of machine technology on industrial organization, we see first of all the huge industrial plants which are the inevitable result of the use of machinery. When efficient machines were devised and power was made available to run them, they were soon set in rows along transmission shafts; the result was the factory, destined to grow steadily as more power was developed and more machines were added, and as better and cheaper transportation, by railroads, steamships, and trucks, widened the market for goods. As more machines came to be used, they were standardized and cost less, a further advantage to the factories using them. Some machines can be used only in a large plant, because only in such a plant is there enough output to warrant the necessary investment; only large-scale production justifies heavy investment in very expensive machinery. Hand methods survive in a few industries, where "variety and distinction, quality and individuality are primary considerations"; but the general tendency has been strongly toward large factories and mass production.[1]

Extensive use of machines, as Slichter points out, increases the relative importance of fixed costs, that is, of the costs which are little affected by changes in output. The manufacturer who uses hand labor can reduce his labor force when declining demand forces him to restrict production; he can throw upon his laborers themselves, or upon society at large, much or all of the cost of maintaining them when he does not need them, and can thus cut his own total costs very materially. A heavy investment in machines, on the other hand, involves a heavy interest charge which, along with taxes, must be met whether the machines are being used or not, and also a depreciation charge which does not decrease much when the machines are idle. This situation doubtless encourages monopoly, for competition in an industry with heavy fixed charges tends to be so destructive that persistent efforts are likely to be made to get prices under control through monopolistic agreements.[2]

Heavy investment in machines also increases the financial risks in industry. When business is slack, the burden of heavy fixed charges may force manufacturers into bankruptcy, particularly if these charges are in the form of bonds or other debt obligations which call for fixed payments at specified times. Heavy fixed charges incident to machine production probably increase the severity of business depressions.

The machine has brought not only big plants and big business, but big cities, big buildings, big farms, big ships, big airplanes. Such huge cities as New York and London could never have been built or supplied with any of the essentials of life before the machine age; indeed, people could not have gone to the cities in such great numbers if machines on the farms had not liberated men from the task of producing food. A hundred years ago 77.5 per cent of all persons gainfully employed were working on farms; today this figure is less than 24 per cent. The others have gone to the cities both because they were not needed on the farms and because they were needed in the cities.

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[1] Harry Jerome, *Mechanization in Industry*, pp. 338 ff.

[2] Sumner H. Slichter, *Modern Economic Society*, 1st ed., pp. 99–101.

With big plants, big cities, and rapid transportation and communication by means of railroads, automobiles, trucks, airplanes, telegraph, telephone, and radio ramifying into every formerly isolated hamlet, our country has become integrated as never before. The United States is no longer an amorphous conglomeration of farms, towns, small cities, and states; it is a unit, closely knit together by a hundred connecting ties—industrial, financial, political, and cultural. Every day thousands of trains pound along the rails carrying food and lumber and coal and manufactured goods and people from farms to cities, from cities to farms, and from one part of the country to another; every day thousands of trucks and busses and millions of automobiles speed along the roads carrying goods and people from place to place, in some cases great distances apart. Every day tons of newspapers printed in the cities, containing world-wide news collected by the great integrated news-gathering agencies, and with advertising aimed at consumers throughout the nation, are loaded onto trucks and express trains that speed out across the country; every day the radio stations broadcast news and entertainment and advertising to workers in Massachusetts, farmers in Kansas, miners in Colorado, ranchers in Montana. Almost everywhere isolation and self-sufficiency have given way before the advance of the machine. Every farm, town, and community must mesh more and more into the great integrated national economic machine.

With integration has come interdependence, of individuals, communities, and nations. The farmer or town dweller of a century ago needed almost no one else's help in his simple life. He knew how to heat his house, or at any rate one room of it—he just cut a tree down, sawed it into stove wood, and made a fire in the stove. The householder of today, with his oil furnace or gas furnace or coal stoker, is usually ignorant of the complicated mechanism and is dependent on a mechanic or electrician for skilled service whenever anything goes wrong, and on a retail agency for his fuel. The farmer or townsman of two or three generations ago knew how to feed his horses, and he could even doctor them when necessary. Today the car owner, unless he is unusually skilled in mechanics, is likely to beat a path to the local garage; and each year's cars are more complicated and further beyond his understanding.

Integration has made communities more and more dependent on other communities. The Kansas or Nebraska town that once got along for the most part on local resources and was the market for its own products is now largely dependent on the outside world for both products and markets. The grist mill, the local saw mill, the plow maker, wagon maker, cigar maker, butcher, ice storage house—these have been largely displaced by great manufacturing plants that sell in many states or throughout the nation. The machine has made every part of the country dependent on every other part.

The machine has brought integration and interdependence for the world as for the nation, for under its impact distances have shrunk, raw materials are available from all over the world, and markets are world wide. The world has shrunk to a fraction of its former size.

This great fact was not grasped by the isolationists who thought it would be possible for us to avoid entanglement in the Second World War. They drew a picture of a self-sufficient United States, living on her own products, selling her goods at home, safe behind the ample protection of her two oceans. Not until the Japanese had struck at Pearl Harbor and in the East Indies did they see how dependent our economic life is on certain imported raw materials such as rubber and tin, just as they failed to realize that in the machine age the ocean has lost much of its defensive value. The world is indeed small, in this modern machine age.

Machine technology, finally, has made possible the great fortunes of the present day. The large plants which it requires mean big fortunes for certain entrepreneurs; and the efficiency of machine transportation has made possible the wide markets necessary to mass production and the building of immense fortunes. Had Henry Ford and Marshall Field lived a century earlier, they might have accumulated fortunes, but nothing approximating what they actually did; this also applies to owners of patents, trade names, and advertising slogans, to the writers of successful songs, novels, and plays, and to popular singers, lecturers, and actors. Lawrence Tibbett or Rudy Vallee might have earned handsome incomes before the advent of the radio and the talkies, but nothing comparable with their present incomes.[4] In agriculture, the machine technology has widened the gap between the more prosperous farmers who adopt this method of farming and the poorer farmers who cannot or will not do so.

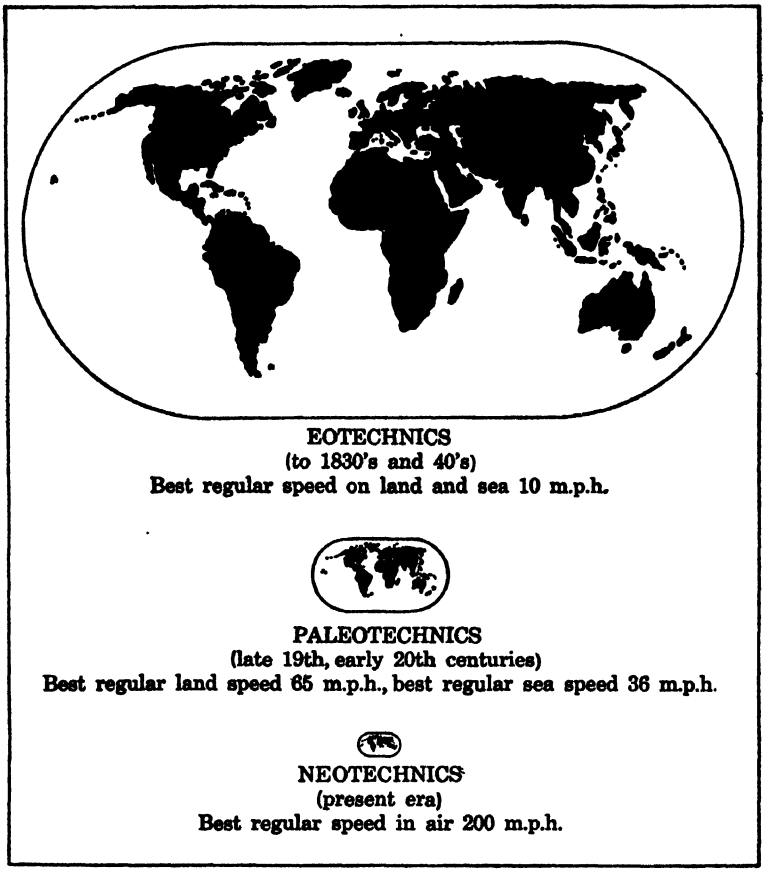
EOTECHNICS
(to 1830's and 40's)
Best regular speed on land and sea 10 m.p.h.
PALEOTECHNICS
(late 19th, early 20th centuries)
Best regular land speed 65 m.p.h., best regular sea speed 36 m.p.h.
NEOTECHNICS
(present era)
Best regular speed in air 200 m.p.h.

FIG. 45. The Shrinking Earth, in Terms of Travel Time.[3]
Size of the world, supposing best travel technology in each epoch were applied over the whole surface of the earth. The speed of airplanes has of course increased greatly since this was drawn.

The machine and political institutions

The machine technology has all but wrecked some political institutions and has brought new ones into existence; it has caused shifts in political power and changes in political procedure; it threatens constitutional liberties, and seems destined to change drastically, if not completely to revolutionize, the political philosophies of the past century. In the first place, it has caused a great increase in the amount of government activity. The small, simple, largely self-sufficient community of pre-machine days, or even pioneer days two or three generations ago, needed few government functions beyond a little policing, the maintenance of some form of court of justice, a little upkeep of the roads, the registration of titles, marriages, and various legal instruments, and the maintenance of schools—the school term was often three months. Government functions were few, partly because the people were too poor to afford many of the public services that we have today, and partly because, in the simple economy of that period, they were not necessary. The vast growth of wealth in the machine age has made the people able to afford public as well as private luxuries; and the increasing integration, interdependence, and complexity of our economy have made government regulation more necessary. So we have the bureaus and the bureaucracy which conservatives cavil about in their spare time.

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[3] From Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16259.

[4] According to a newspaper story, the weekly salaries paid to leading actors in the 'seventies amounted to $200 for Fanny Davenport, $80 for Maurice Barrymore, and $50 for John Drew.

In the second place, the machine age has brought a relative decline in local and state government functions and a steady increase in those of the federal government. Because of the slow and laborious transportation facilities, the pre-machine community lived largely to itself, within its own narrow limits, and depended largely on the local government for the few public services it needed. Today, although the local unit supports a more expensive and elaborate school system, it has lost many of its functions to the county, state, and federal governments. Policing has been taken over more and more by state and federal agencies, particularly the Federal Bureau of Investigation; road construction and maintenance are more and more a function of the state government, aided by contributions from the federal government. As improved transportation and communication enlarged the radius of economic activities, state and federal governments took over more and more of the functions of the local governments, except in the case of municipal units, whose functions have also expanded. In the same way and for the same reasons, state governments are losing to the federal government, not absolutely, for they actually render more services than formerly, but relatively, much to the distress of those upholding the doctrine of states' rights. Some of its adherents demand that the federal government return to the states the powers and responsibilities it has "usurped"; but machine technology has made this impossible. The only way to restore states' rights is to eliminate automobiles, busses, trucks, tractors, radios, and airplanes, and, to restore the states' rights of Washington's time, eliminate the railroads too.

Not only have federal functions expanded, relative to those of the state and local governments, but within the federal government itself the President has assumed more and more powers at the expense of Congress. This has been done, not because of a craving for dictatorial powers, but because, in our integrated but complex economy, the federal government *must* do many things, and the President must assume leadership if much is to be done. Congress is generally better at talking than at doing things. The growing presidential power offers no threat to our democracy but on the contrary is essential to its preservation, for if the government does not have effective power, such as it can have only through strong presidential leadership, our country will be dominated by giant corporations and associations of them. President Franklin D. Roosevelt once said that he was only trying to move the capital from New York City to Washington.

Machine technology, and the highly integrated and organized economy which it has begotten, appear to demand a new political philosophy. "Rugged individualism" was appropriate to an economy in which the individual counted heavily, in which most business was carried on by individuals; but it is hardly appropriate to one dominated by great corporate combinations. Some able economists and political scientists even insist that capitalism, which is essentially individualistic, is an anachronism in the machine age, and that it must presently give way to some form of collectivism—socialism, communism, or Fascism. Certainly the individual, standing alone, has a hard time in the modern world.

Social aspects of the machine age

In recent years there has been considerable discussion of the social aspects of the machine age, of the kind of civilization we have built with our myriads of machines. There have been two opposing camps among the writers, one glorifying machines as the basis of all that is comfortable, beautiful, and good; the other seeing in them ugliness, exploitation, perhaps the final destruction of civilization.

Wealth. At the risk of appearing to invade the domain of sociology, we shall consider some of the effects of the machine on human life generally. Machine production has greatly increased the wealth and income of the people. Estimates of wealth are subject to a considerable margin of error, but the figures in the table below may be worth quoting.

This wealth has brought, concretely, a thousand comforts, conveniences, and luxuries that we are accustomed to take for granted: a wide selection of healthful foods, some of them brought from hundreds of miles away or even from foreign countries, fresh, canned, or frozen, and therefore in a nearly perfect state of preservation, a practical impossibility before the relatively recent development of canning and refrigeration; a wide selection of clothing, as comfortable and attractive as style demands permit, and, in terms of human labor costs, mostly very cheap; cleanliness, of person, clothing, and surroundings, such as few peoples enjoyed prior to the past century; comfortable, convenient, healthful, and even sometimes beautiful houses and furniture; cheap, convenient, and definitely luxurious means of transportation by automobile, bus, railroad, boat, and plane, travel on a scale never dreamed of even half a century ago. This wealth has given us a million miles of paved and graveled roads for all-weather travel, generally better than the pavements of New York City at the time of the Civil War; cheap recreational facilities for the masses in the form of moving pictures and radio broadcasts, better facilities than were available fifty years ago anywhere but in a few of our largest cities. It is our wealth that makes possible the maintenance of more than a thousand colleges, with a total enrollment of about a million students. All these things could be better—and we must maintain a critical attitude so that they may be made better—but we must concede that in providing the wealth which has made them possible, the machine has done a great service.

Some people are inclined to idealize the past too much—the good old days, the idyllic age of Sir Walter Scott, when manly and chivalrous knights paraded and fought and saved beautiful maidens from various dangers; when the happy husbandmen of "The Cotter's Saturday Night" plowed the stubborn glebe all day and came home to the joys of their simple homes in the evening; when master craftsmen worked joyously on beautiful vases and statuary that were to be the admiration of succeeding centuries; in short, when life was simple and beautiful and natural. Balzac lapsed into this sentimentality when he wrote: "Modern industry, toiling for the masses, goes on destroying the creations of ancient art, whose achievement was as personal to the purchaser as to the maker. We have *products* nowadays; we no longer have works." Much of the glamour

The Growth of Wealth and Population in the United States[5]

Year	Total Wealth	Population	Per Capita
1790	$ 400,000,000	3,929,000	$ 101
1800	620,000,000	5,308,000	116
1810	1,217,000,000	7,240,000	168
1820	2,588,000,000	9,638,000	268
1830	3,825,000,000	12,866,000	297
1840	5,226,000,000	17,069,000	306
1850	7,136,000,000	23,192,000	308
1860	16,160,000,000	31,443,000	514
1870	30,069,000,000	38,558,000	780
1880	43,642,000,000	50,156,000	870
1890	65,037,000,000	62,948,000	1036
1900	88,517,000,000	75,995,000	1165
1912	186,300,000,000	95,097,000	1950
1922	320,804,000,000	109,248,000	2918
1930	428,126,000,000	122,775,000	3487
1938	388,421,000,000	130,215,000	2982

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[5] Robert R. Doane, *The Anatomy of American Wealth,* Harper & Brothers, p. 26.

of feudal times is doubtless the result of the way history has been taught, for it deals mostly with kings and nobles and knights and princely stuffed shirts—or stuffed armor—and their wars, tournaments, and intrigues, and is little concerned with the wretched lives of the masses of the people. Pioneer life is usually idealized similarly in poems and novels, although many recent writers have pictured it more realistically.[6]

The truth is that before the machine age, life for almost all people was unbelievably hard, tedious, meager, dirty, cruel, and short. Food was poor, sometimes partly spoiled, and often insufficient; clothing was coarse, dirty, and uncomfortable; homes lacked glass windows and were heated, if heated at all, by drafty fireplaces; there was no furniture, not even beds, for the people slept on piles of vermin-infested straw. Through the use of slaves or serfs, princes and rulers could maintain a rude luxury, but no prince lived as comfortably or healthfully as an ordinary skilled artisan in America does today. Poets and idealists—John Ruskin, for instance—have pictured the medieval period as a "golden age" of simple contentment; and there was a measure of contentment, in the sense of stolid acceptance of the hardships of life and lack of ambition to improve conditions. Yet there was much suffering and, partly as a result of that, callousness, meanness, and dishonesty. In Marshall's words: "Adulteration and fraud in trade were rampant in the middle ages to an extent that is very astonishing, when we consider the difficulties of wrong-doing without detection at that time."[7]

As to the life of Americans fifty or seventy-five years ago, when the machine technique was fairly well advanced but had not reached the extraordinary peak of today, our view must be somewhat different. Most people lived simply. There was little variety in food because refrigeration was not widely available, and farmers and the people in the smaller towns and cities lived largely on the products of the surrounding countryside. Clothing was fairly adequate, but not as good as it is today, the current vagaries of styles in women's clothing being excluded. Houses, although often large, were by no means as comfortable, convenient, or healthful as modern houses. Generally only one or two rooms were heated in winter, and there were few bathrooms; few houses had running water. Entertainment was simple and was largely provided by the people themselves—church services, spelling schools, ciphering matches, singing societies, home-talent plays, and, in the less puritanical communities, dances. Life was rather tedious and boring compared with what it is today, the health of the people was relatively poor, and the average life expectancy more than twenty years shorter. Against the simplicity, hardships, and tedium of life, the poor health and the shorter life expectancy, however, must be balanced the fact that people were probably as contented as they are today, and probably more hopeful. They were sure that the world was growing better and would continue to do so. Their problems were relatively simple, they did not face the baffling complexities of our present age, and they never were forced to see their civilization crumbling before their eyes.

Population increase. On the solid basis of increased physical wealth and productivity, the population of the capitalist countries has risen very greatly. The population of Great Britain was estimated at something over 6 millions in 1651; today it is 50 millions. The population of the world, which was about a billion in 1850, is nearly 2 billions today. If an increasing population means lower standards of living, it is nothing to be happy about, but this increase has been accompanied by a generally rising standard of living. It has been due not to an increasing birth rate, but to growing wealth and productivity and a declining death rate; and if life on the whole is good, the machine may be credited with making that goodness available to many millions who otherwise could not have lived.

Health and longevity. Greater wealth, better food, clothing, and houses, increased cleanliness, and the skilled sanitary and medical services that the machine age has brought have raised health standards and lengthened the span of life. Today people are much healthier, taller, heavier, stronger, and they live much longer than they did even a few decades ago. Among Yale University students in 1883, for instance, only 4.3 per cent were six feet tall or over; today 22.6 per cent are "six-footers." The average weight in 1883 was 137.7 pounds; today it is 151.1 pounds. Prior to the eighteenth and nineteenth centuries many people suffered from ills that are now little known in advanced countries—leprosy, cholera, dysentery, smallpox, malaria, rheumatism, scurvy, toothache, earache, acute indigestion—and from other diseases that are far less common today, such as tuberculosis, typhoid fever, and diphtheria; and the death rate was very high. Probably half the babies born died in infancy. Although statistics on length of life are unreliable, the average life span has probably more than doubled since Roman times and has almost doubled within the past two centuries. According to one estimate, the average life span of men in the United States in 1780 was 35.5 years, whereas today it is nearly 65 years. Before the machine age, people knew the face of death, and they feared sickness as no one can understand in our age of good health and long life.

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[6] For realistic pictures of pioneer life, see Mari Sandoz, *Old Jules;* Howard Ruede, *Sod House Days: The Letters of a Kansas Homesteader;* John Ise, *Sod and Stubble;* and Willa Cather, *My Antonia.*

[7] Alfred Marshall, *Principles of Economics,* p. 7. In the first chapter of Book I, Marshall discusses the relation of wealth to character with judicious balance.

Kindness and humanity. With material comfort has come a habit and tradition of kindness and humanity which is perhaps the greatest achievement of our age. Except for the family or patriarchal circle, it is almost new in history, for mercy was little known in ancient and medieval civilizations. Even in the generally cultured Greece of Pericles' time, the moral justification of slavery was seldom questioned. The brutality of the early Hebrews is indicated by many passages in the Old Testament, for instance in the merciless slaughter of the men in conquered cities and provinces who were cut "with saws, and with harrows of iron, and with axes"—David's treatment of the people of conquered Rabbah. The general brutality of the rulers and people of Rome was shown in the bloody contests in the arena and in the popular enjoyment of this bestiality. When Crassus defeated Spartacus and captured most of his followers, he crucified 6000 of them along the Appian Way. That the same brutal spirit prevailed during the Middle Ages is shown by the ghastly tortures inflicted by the Inquisition—burning at the stake or with hot irons, roasting in the "roasting bull," flogging, burying alive, hanging by the thumbs or toes, crucifying, crushing the thumbs or legs, blinding, or life imprisonment in chains in dungeon. Even as late as 1820 there were 260 offenses in England for which men, women, and children were put to death. William Jennings Bryan used to object to the idea of being descended from a monkey, but for some reason he could see nothing humiliating about having the human beings of ancient or medieval times as his forebears.

With the growth of wealth and the rising standard of comfort brought by the machine era, the quality of kindness and humanity spread throughout the civilized world. Only a few of the countless manifestations of its spread can be mentioned here—the gradual emancipation of women, who formerly were regarded as personal property or as slaves, almost entirely without rights, and subject to gross abuse and degradation; the increasingly considerate treatment of children, who even in the early capitalist period were treated as chattels devoid of feeling, and often beaten unmercifully in accordance with the Biblical injunction, "Spare the rod and spoil the child"; the gradual humanization of the treatment accorded criminals and insane persons; the emancipation of slaves; the humanization of religious doctrine, the change from the fire-and-brimestone appeal to that of love and mercy; and finally, the gradual development of a feeling of mercy for animals. The idea that animals can suffer, although not entirely new, is largely a product of the age of relative plenty which came with the machine.

The most fundamental factor in this trend toward kindness and humanity has been the growth of wealth. During the long ages of poverty when everyone suffered a great deal, there could be little sympathy with the sufferings of others; when almost everyone was desperately hungry at times, no one could be harrowed by the sight of others who were hungry; but when people could be comfortable themselves, they could enjoy the luxury of sympathizing with others. Something analogous might be said with respect to generosity. People who are always on the verge of want can seldom be generous, for they sacrifice too much in being so. There is more generosity in the world today than in any other period of human history, not because the natural dispositions of people have changed, but because their condition has improved.

Recreation. The machine age has brought increased opportunities for recreation, whatever may be said as to the quality of some of our present recreational activities. Life was rather tedious in the "good old days"; there was less play and entertainment than one might assume from reading Boccaccio or hearing the operas that are set in feudal times. It is difficult to realize how bored people were, even in pioneer communities, when men would walk ten miles to read a newspaper, would walk or jolt along in wagons even greater distances to listen to execrable sermons—would do almost *anything* to get away from the tedium of their homes. Today our automobiles, moving pictures, radios, phonographs, musical instruments of all kinds, telephones, newspapers, toys, and amusement parks leave little chance for most people to be bored, unless it be by their own intellectual vacuity. Recreation has become one of the largest businesses in the country. Stuart Chase estimates that it absorbs more than 10 billion dollars a year, about one-sixth of our total national income. Fishing alone has been estimated to cost some 500 million a year.

In two respects our recreational activities fall short of a rational ideal. In the first place, we take too much of our recreation secondhand, by proxy—we climb mountains in automobiles, listen to others sing, and watch others play, when we might be singing and playing ourselves; we read reviews and digests instead of books, sit under electric lamps instead of walking in the sunshine, exercise with an electric manipulator; as children we play with toys from the ten-cent store instead of making our own toys. As Stuart Chase says:

> A few play—or better work—on gridiron, race track, diamond and prize ring—while the rest of us shout, clap hands, hurl pop bottles at the umpire, crush our neighbors' hats, and get what thrill we may from passive rather than active participation. Our play comes to us, in these circumstances, at one remove from reality. When we watch a score board outside a newspaper office, it comes at two removes. This was not the idea in the New England town; indeed, save for the Coliseum of Imperial Rome, it has never been the recreational idea of mankind. Down the ages we have watched and listened at theatres, bull fights, concerts, but how small a part it has been of the total play activity. Today it is the larger part, and I suspect the ratio is increasing—despite the new golf players and the campers.[8]

Philosophical folk often enjoy criticizing the unsophisticated masses for the way they spend their leisure time, but the truth is that the people have always entertained themselves in ways that the self-styled cultural elite thought vulgar, and there is no reason to believe that they behave any worse than they used to; on the contrary, it is certain that their standards of entertainment are higher than they ever were before the machine came.

We unquestionably get much better singing, better acting, better services and commodities, by depending on others to supply them; nevertheless, there was something worth while in the singing schools, home-talent dramatic and debating clubs, homemade toys. A certain development of personality is inherent in doing things for ourselves; and the boy who knows all the constructive possibilities in a jackknife has something that will never be appreciated by the pampered and surfeited youngster with a bushel of dime-store toys. That some of the activities of a simpler age satisfy a deep-rooted craving is indicated by the fact that we often return to them when we have leisure and opportunity. Many people like to camp out for a short time, cook over an open fire, fish, hunt, work in wood, hoe in the garden; Boy Scout activities represent largely a return to the simple life; fireplaces bring a touch of the primitive into the artificiality of our comfortable homes. Perhaps in all this there is a longing for the hardihood of a past age, a hardihood that has been lost because of the comforts of modern life. There is genuine essence of living in being hungry if we may eat, in being cold if we may warm ourselves, in being physically tired if we may rest, in feeling any biological craving if we may find satisfaction. We may miss something fundamental when we are seldom really hungry or physically tired, never cold, and surfeited with gratifications before keen wants have been felt. To the extent that life consists in feeling sharp wants and satisfying them, we are a little like dead men who feel no hunger, cold, or fatigue, nor the satisfaction of them.

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[8] Stuart Chase, *Men and Machines*, pp. 259–260. By permission of The Macmillan Company, publish-

Decline in opportunities for individual achievement

The assignment of the function of providing recreation to fewer and fewer specialized experts—singers, actors, and athletes—gives us far better services, but it constantly narrows the opportunities of those prepared to render them. Before the advent of the radio we needed many musicians; today a few can entertain many listeners because the radio can reach millions. Before the development of moving pictures, careers were open for many actors and actresses; today a relatively few stars are required to reach a vastly enlarged public audience. The best or most popular may earn fabulous incomes, but only for them is there any decent reward. Thus our machine technology has narrowed the field of opportunity while it has greatly accentuated inequalities of income.

This tendency is present in other fields of human achievement. When the steel business was in the hands of many small owners, there were as many opportunities for business leadership as there were companies; today the United States Steel Corporation controls nearly half the industry, and there can be only one general manager, with subordinate managers for the individual plants. The president of the corporation draws a huge salary and a few subordinates fare reasonably well; but the army of common laborers, foremen, and clerks work for modest or subsistence wages and have little rational hope of promotion. In medicine and law, an increasingly large part of the remunerative business gravitates to a few well-known specialists and firms for various reasons, an important one being improved transportation and communication. Thus in many fields the world is being so organized that more and more of the privilege, power, and economic reward go to a few able or lucky persons.

Machine domination of the habits of life

Whether for good or evil, the machine process, as Veblen points out, "pervades the modern life and dominates it in a mechanical sense. Its dominance is seen in the enforcement of precise mechanical measurements and adjustment and the reduction of all manner of things, purposes and acts, necessities, conveniences, and amenities of life to standard units. . . . In the nature of the case the cultural growth dominated by the machine industry is of a skeptical, matter-of-fact complexion, materialistic, unmoral, unpatriotic, undevout."[9] Our machines are standardized, exact and prompt in action; and men adjust themselves to them not only directly but indirectly in their daily lives and their attitude toward cultural and moral questions. In its exactness and promptness, life today differs greatly from that of only two or three generations ago, when such commonplace devices as clocks and watches were little used, when many people reckoned time by looking at the sun; when dinners, church services, and concerts began at "about" a certain time, or as soon as everyone arrived; when trains were usually late, and life generally slow and leisurely.

The speed of life

The speed of modern life is an obvious result of the use of machinery, not altogether bad, yet in many respects a serious threat to the soundness and wholesomeness of our civilization. If our forefathers were bored by the slowness, tedium, and monotony of life, we are quite as certainly being driven like galley slaves by our relentless machines, faster and faster each year. Each year's automobiles are built for higher speeds; almost every year the death total from automobile accidents rises—it was just under 40,000 a year before the war—each year the railway trains and busses and trucks and ships and whirring wheels move a little faster. Many of us discover that in the mad hurry of life we cannot find time to live. We have a lot of "things" in these hectic days, a lot of movement, but little time for living—unless these be living.

In a sense our machines drive us directly. The factory manager is driven by competition

[9] Wesley C. Mitchell (ed.), *What Veblen Taught*, pp. 306, 367.

to speed up the machines, and the laborers must keep up with them; the deliberate automobile driver who would like to follow his own pace and enjoy the scenery soon finds himself anathema to those who desire to travel as quickly as possible, and sometimes signs reading "Not under 30 miles per hour" threaten him with arrest if he does not speed up.

The main incentive to speed is indirect, however, the drive to keep up with the Joneses and to avail ourselves of all the things that machine technology has made available. Modern transportation, communication, advertising, and salesmanship—all of them important features of the machine age—have intensified the struggle to keep up with the Joneses by making everyone more conscious of the pace that the Joneses are setting. There is little if any general gain in this social marathon, for no matter what the pace, some of the Joneses will still be ahead. And machines have made so many things available that we are driven hard, if not by our own desires, by those of the good wife or children or friends, to try to enjoy as many as possible.

The waste of natural resources

Thus the machine technology is wasteful of human resources in some ways, but it is far more wasteful of natural resources. The same efficiency that enables our machines to turn out vast amounts of goods enables them to tear fuels and metal ores out of the earth, to slash the forests, and to gouge and waste the soil at a truly alarming rate. Earlier civilizations depended for their support on the "from-day-today" energy of the universe; but today 85 per cent of the energy used by our civilization comes from the irreplaceable energy stored up in early geological ages. The machine has used up more oil in the past ten or twelve years, and more minerals in the last thirty-five years, than were used in all history; and the total fuel consumption shows a steady and rapid rise, despite the fact that our engines and machines are being manufactured to develop a given efficiency with less and less fuel.[10]

Standardization of life

The cry is often raised that our machines have robbed life of the richness of variety by standardizing not only goods but human life as well. The Woolworth and Kress chains offer numberless articles identically the same in every store between Maine and California; and many artistically-minded people see in this trend a dead-level standardization characteristic of modern life.

In one sense, machinery of course has standardized products, *particular* products; a thousand articles in common use—Ford cars, Camel cigarettes, Regal shoes, General Electric refrigerators, Ivory soap, nails, pencils, buttons, pins. Machines *must* standardize, for usually they can produce only identical products. But they have standardized not only products but the physical aspects of towns and cities. One can drive through a hundred towns and cities in many sections of America and see scarcely a single characteristic by which to distinguish one from the other. Machines have standardized styles, too, geographically and on the basis of social classes; the salesgirl in Lander, Wyoming, dresses much like the New York

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[10] Some idea of the increasing efficiency in the use of fuel may be gained from the following figures:

Fuel Consumption per KWH by All Central Power Stations (1882–1934)

Year	Coal (or Equivalent) Consumption
1882	10.0
1892	8.0
1902	6.7
1907	5.4
1912	4.4
1917	3.3
1922	2.5
1927	1.84
1932	1.50
1933	1.47
1934	1.44

heiress, though more cheaply, and, like many other girls throughout the breadth of the land, affects the Katharine Hepburn hair-do when that is "the rage." Even moral codes are to some extent standardized; rural puritans in Kansas gape unblushingly at the bedroom scenes in the latest movie much as New Yorkers do, perhaps even on the Sabbath day, which was once reserved for worship of a different sort. Moving pictures have done this to us. And under their impact and that of the radio, cultural habits and standards likewise tend to geographical uniformity; the same jazz and cowboy songs, the same babble about contented cows, cool gasoline, crispy crackers, and crazy crystals for crazy people are heard in every corner to which American culture has penetrated.

While machines thus standardize particular products, they turn out such a vast quantity and wide diversity of goods as to lend variety, rather than monotony, to our homes and lives. Plenty of machine-made chairs are quite as artistic as no chairs at all; and but for our machines, many homes, as in China and India, would have few if any chairs. The scores of conveniences, machine-made gadgets, gewgaws, and knickknacks in the modern home are not there in place of beautiful handmade things that would have been there but for machines; they are there where nothing was before the advent of the machine. Furthermore, as Stuart Chase says, "One of the outstanding facts governing a machine culture is its restless and remorseless change." Styles in clothing, in cars, in homes are established, only to be changed the next month or the next year; and our machine technology operates in such a way that the people, naturally hostile to innovations, must finally accept not only the changes but *the general idea of change*. When bathtubs were first used, there was great public hostility to such newfangled innovations, and certain legislative bodies considered laws to prevent their introduction; but the powerful profit motive was behind their manufacture, and bathtubs triumphed over human conservatism. Many people can remember the hostility to bicycles a generation or two ago, and to automobiles later, because they were used only by the rich and because they scared the horses. It is entirely possible that if this had been left to the vote of the people, these creations of the devil would have been outlawed; but machine technology had its way. By flank attacks, by nibbling at one sector after another of the battlefront of human inertia and conservatism, our machines win every battle. Individual manufacturers would be glad to rest on their oars, but where competition prevails they must be alert, must change and improve their products or fall out of the march of progress.

The same principle applies in the cultural realm. While the radio and the movie popularize the same cheap jazz and comedy through the breadth of the land, they also popularize a wide variety of other things; the average person can hear and see a hundred times as much good music and drama as he could twenty-five years ago. A popular preacher like Father Coughlin could reach millions with his voice; but as long as other preachers and politicians, with different views on religious and economic questions, also have access to the public ear, there is no danger of standardization of our religious or economic ideas. In Fascist countries like Germany and Italy there was a deadly standardization of public opinion and ideals on a level which approximated barbarism; but in the United States the influence of the radio and the movie has led to variety and to generally higher levels of public intelligence and culture. It is difficult for modern Americans to realize the hold that traditions and taboos and conventions had on the people in the good old days.

The complexity of life and of political problems

Concerning another aspect of our machine age, we may not be so complacent. Life has become so complex that it is not yet certain we shall be able to solve all the baffling problems that our machines have created. Adam Smith's "invisible hand," which was to preserve order in a chaos of pounding engines and whirling wheels, is still invisible, and offers less evidence of its potency than it did in his time. The early pioneer had only a few rather simple problems to solve; but today's interdependence of men, of classes of men, and of nations has raised a hundred problems that call for public intelligence. We may leave to the philosopher the question of whether man can be as happy in a complicated society as in a simpler one; but we cannot hide our heads in the sand and ignore the problems that are piling up ahead of us. We must decide collectively what we shall do about public utility control, monopoly, shipping and air-mail subsidies, corporation exploitation, tariffs and foreign trade, railroads and trucks and busses, agricultural surpluses, reforestation, soil erosion and terracing, taxation and budget balancing, unemployment and social security, price levels and monetary regulation, war and peace. The people of the Fascist countries of Europe finally confessed their inability to solve the critical problems of the postwar era and surrendered their democratic privileges to dictators. It is not yet quite certain that the people of the United States will be able to do any better.

The cultural lag

We could be more hopeful of solving the complicated problems raised by the machine age if it were not for the stubborn fact of the cultural lag—the lag of economic, political, and cultural institutions behind technical progress. We see this lag in the difficulty and slowness with which the Constitution is changed to meet the needs of our changing economy. Many of its provisions seem eternally good; but others, such as those governing the division of state and federal powers, are in grave need of revision. The Constitution was adopted at a time when transportation was slow and inefficient and there was little interstate commerce; today most trade is interstate, and state lines, as far as economic organization and functions are concerned, have been largely obliterated; yet the constitutional provisions of 1789 still apply, with such amendments as the Supreme Court has made at various times through interpretation.

Similarly, since the dominating political theory when the Constitutional Convention met was that government functions should be kept at a minimum, the branches of our government—President, Senate, House of Representatives, and Supreme Court—were set up in such a way as to make legislation difficult to secure; today many problems demand legislation which our government machinery is not designed to provide. The ineptitude of Congress becomes more evident each year; Congress, however, was not designed to do the things that have been demanded of it in recent years. Senators and Representatives, it should be remembered, represent not the country as a whole, but only their own particular states and districts. They are not responsible for the effect of their official acts on the national economy. This was not serious when the states were largely isolated and Congress had little to do except to raise the tariff occasionally and keep the pork barrel filled. The economic integration and the centralization of economic power characteristic of the machine age, however, call for a corresponding political integration and centralization of power and of responsibility as well. This has taken the form of dictatorships in some countries, and must appear in the United States in one way or another. The machine has engendered critical political problems which call for all the intelligence and common sense that the American people can muster.

The machine and war

The most appalling example of the cultural lag is perhaps the fact that many peoples throughout the world cannot realize the fact of world integration, cannot see that the old national boundaries have today lost much of their importance. The same inventive genius that gave us the turbine, the tractor, and the automatic loom gave us also the atomic bomb, the submarine, the tank, the robot, and the Superfortress. We seem to be as efficient in destruction as in production; the destruction, however, is no longer confined to the field of battle but spreads over cities hundreds of miles behind the battlefronts. In the Second World War hundreds of churches and other historic structures such as libraries and museums that had survived centuries of warfare were reduced to ruins. Now we have the atomic bomb. Is it not fairly certain that another world war—and future wars are likely to be "world" wars because the world is an integrated unit—will destroy much of what we call civilization? The engines that made possible modern civilization, with its comforts, democracy, and humanity, will then have wrecked it, and warring nations will sink back to some sort of feudal barbarism. If this seems fantastic, let us remember that the

Hitler regime was the indirect result of technological advance which had paralyzed the German economy, and that if he and Hirohito had won the Second World War, civilization would have perished throughout most of the world. Not a few of the ablest thinkers of today believe that civilization is on its way out, as a direct or indirect result of the advance of machine technology.

Major Alexander P. de Seversky, author of *Victory Through Air Power,* has drawn an alarming picture of future wars:

> The destructive power of electronics, the lethal resources of modern chemistry, have scarcely been tapped. Within a decade or less they will be ready to visit horror on man in new and almost unimagined forms. The splitting of the atom, already achieved in the laboratory, will release colossal energy to further enhance wholesale annihilation. War will become a gigantic clash of mighty technological monsters, striking from the heart of one nation directly at the heart of another, perhaps half way around the world, with a fury and destructiveness that will make all past conflicts—including World War II—seem trivial by contrast. The aim will be total annihilation. Therefore I say that we simply cannot afford to be lazy or cynical about peace plans if we want to survive—if we want our children to survive.

Pointing the moral, Seversky continues:

> The nations of the world hold in their hands scientific force capable of blowing all civilization to bits. But our moral sense has not kept pace with this almost incalculable growth of physical powers. . . . The gulf between our available technical power and our moral understanding has widened disastrously. It is a terrible abyss which may swallow everything that the human race has prized.[11]

At the time when Seversky was writing, only a few years ago, many people thought him something of a crank, quite too much alarmed about the future; but the atomic bomb makes his predictions seem moderate and reasonable. Even in its present state of development, the bomb is capable of destroying all cities, and it will of course be "improved."

It is probable that some of our most wonderful machines have been a detriment to society. The airplane, for instance, has been developed at a heavy net loss; and if we were to judge it by its present contribution, constructive and destructive, we should want to erase it from the face of the earth. Against its unimportant service in expediting the transportation of letters and express and passengers, most of whom have little worth while to do with the time they save, must be balanced the financial burden of air armament throughout the "civilized" world, the cost of constructing bombproof cellars and providing gas masks, and the actual destruction from air bombardment. A Pandora's box was opened when the airplane was invented.

We may some day wish that even the radio had never been invented; in fact, Lewis Mumford suggests that "at the present moment, as with so many other neotechnic benefits, the dangers of the radio and the talking picture seem greater than the benefits."[12] The radio does indeed bring us operas and concerts that could once be enjoyed only by people living in large cities; but it may some day bring the end of our democratic liberties and civilization. The part it played in the growth of Fascism in Europe has not been carefully analyzed, but it was undoubtedly very important. As Mumford points out, the radio has restored "direct contact between the leader and the group"; and this may increase the amount of mass regimentation as it did in Germany and Italy.

There may be forces in the human mind capable eventually of meeting these threats. Men may yet find some way of controlling their engines of destruction, of solving the baffling problems of the machine age, and may set us again on the way to peace and plenty, but to the present time they have made little progress; they are today further behind in their understanding of the problems created by technological advance than they have ever been before. It is clear, for instance, that the atomic bomb has made some kind of effective world government and world peace necessary to the survival of civilization; yet none of the victorious United Nations appears to be seriously interested in maintaining peaceful international relations. Even in the ominous shadow of the atomic bomb, they are engaged largely in scheming for position in the old imperialist struggle for colonies and "spheres of influence," the capitalist nations cooperating only in efforts to subjugate former colonials who have conceived presumptuous ideals of self-government, Russia following the same general policy alone. The people cry "Peace, peace," the atomic bomb demands peace, but there is no peace. We have the bomb now, but we do not know what to do with it. We might well wish we could drop it into the deepest ocean, with all scientific knowledge as to its manufacture; but this is impossible. Other nations will soon have it, and then the problem of its control will cease to be a subject for parlor patter and diplomatic intrigue. Then the problem must be solved. Looking at present international diplomacy, we can have no confidence that the solution will be a happy one.

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[11] *The Progressive,* July 3, 1944.

[12] Lewis Mumford, *Technics and Civilization,* p. 241.

QUESTIONS

1. Machine technology increases the relative importance of fixed costs. Why? What effect does this have on the amount of monopoly in our economy? Why?
2. Why does the machine encourage "bigness"? Give illustrations.
3. How does machine technology increase personal interdependence? Regional interdependence?
4. Machine technology is largely responsible for most of the great fortunes. Why?
5. How would you go about restoring states' rights in government? Must we look forward to continued expansion of the powers of the President?
6. Trace some of the many respects in which individualism has been on retreat as machine technology spreads.
7. What are some of the beneficent results of the machine for human life? What are some of the evil influences?
8. "Even if work, in the machine age, is sometimes rather monotonous, *life* is far more interesting than it used to be." Illustrate.
9. The world offers a less satisfying, less dignified career to ordinary men than it once did. Why?
10. "The watch, particularly the wrist watch, is the symbol of our subjugation to the lockstep of modern industry." Do you agree? Would it not be inconvenient to get along without watches? Would it be possible today? Why were our great-grandfathers able to do this? Was there any virtue in such a life as theirs?
11. "There are so many things that we would like to have and enjoy in the machine age that we are driven like slaves by our desire to get as many as possible." What better situation could you imagine than to have so many things available for your purchase and use?
12. In what sense have machines standardized our lives?
13. Why are political problems more numerous and more difficult than they were before the machine age? Mention some that will have to be solved if the world is ever to have a stable peace.

Chapter 36.

An Appraisal of Capitalism

Since the debut of simple capitalism, back in ancient Athens, the capitalist system has been under attack from a succession of critics, many of whom have advocated socialism, communism, or in recent years Fascism, as a better system. Some of these critics have questioned the fundamental assumptions of a capitalist economy; others have protested against what they considered the ugliness, crudity, greed, materialism, wastefulness, hurry, restlessness, and lack of culture of capitalist civilization; still others have been harrowed by the inequalities of wealth and the degradation and hopelessness of the poorer classes. Lincoln Steffens was impressed with some of the contradictions in the capitalist philosophy: "The ideals of America, for example, the ideals that came to Ohio probably from New England and from old England, are antiquated, dried up, contradictory; honesty and wealth, morality and success, individual achievement and respectability, privileges and democracy—these won't take us very far."[1] It will be worth while to consider some of these criticisms and weigh them against the virtues of the capitalist order in order to strike a balance of debits and credits and make as fair an appraisal as we can, because capitalism is under trial as never before, and its survival cannot be assumed as a matter of course.

Assumptions of capitalism

Some critics of capitalism have questioned the assumptions of the capitalist order. Henry C. Clay, an English economist who has done this well,[2] lists four assumptions as implicit in the capitalist economy: (1) "That individuals in their economic relations can be relied on to pursue their own interest, and that their action will be reasonable rational and informed"; (2) "that competition in industry will result in the survival of the socially fittest"; (3) "that *as a rule* private wealth or property will be acquired only by service and, conversely, that services will be induced by the possibility of acquiring private wealth, so that it will be the private interest of some one to supply every service in which there is a public interest"; and (4) "that market values correspond roughly with social values, and are an adequate indicator of need for production to follow." It will be pertinent to examine these assumptions critically.

The assumption of rational self-interest. We hitch our economic freight to the engine of selfishness on the theory that selfishness is the most reliable human motive. If people would work as hard and as effectively for the general good as for their own selfish interests, communism would perhaps be a better economic system than capitalism; but most economists follow Aristotle's famous tenet, that people are "more desirous of gain than of honor." Carver defends this reliance on selfishness, or "self-interest," on the ground that every person knows his own interests better than anyone else does, and better than he knows the interests of anyone else, and that therefore self-interest will provide for the interests of all better than any other system, and with a smaller expenditure of human energy.

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[1] Lincoln Steffens, *Autobiography*, p. 494.

[2] Henry C. Clay, *Economics for the General Reader*, chap. 22.

Biologists would presumably approach the question in a slightly different way, by assuming that self-interest has persisted because it has survival value; that is, because those individuals or groups which were self-interested survived more generally than those which were not. The biological analogy also suggests, however, that a well-developed capacity for cooperative action must likewise be present in the human race, because most monkeys and other simians are highly gregarious and work together for common ends. At any rate, it is significant that since the time of Aristotle, the first great conservative, most conservatives and defenders of the capitalist system have held a rather low opinion of human character and have assumed that self-interest is the only reliable motive on which to base an economic system, whereas socialists have assumed that man is capable of response to other motives. Marshall came to the conclusion that "history in general, and especially the history of socialistic ventures, shows that ordinary men are seldom capable of pure ideal altruism for any considerable time together," but he conceded that "no doubt men, even now, are capable of much more unselfish service than they generally render."[8]

The socialists, it should be noted, do not deny that men, as at present constituted, are moved largely by self-interest; but they insist that this is mainly because of the environment in which men have been reared, and that if they were reared in an environment in which self-interest was stressed less and the general good more, they would be unselfish enough to respond to incentives other than that of personal gain. Socialism, communism, and Fascism all rely to some extent on other motives than self-interest; and in time, if these systems survive, we may know whether these other motives are reliable enough to serve as a basis for a stable economic system.

The self-interest must be informed and rational, however, if capitalism is to work successfully. Although this has already been discussed, we must take it up again here. To the extent that consumers are unable to appraise goods and services rationally, there is no reason to assume that the capitalist system will operate to provide goods of satisfactory quality at reasonable prices; and we must concede that consumers are gravely uninformed and irrational in many of their purchases. In the first place, many people are naturally dull, indolent, thoughtless, averse to the mental effort necessary to make intelligent choices; in the second place, there are so many things they would have to know, in order to buy rationally, that only a walking encyclopedia could have this amount of information; in the third place, from the nature of the situation, even active and intelligent buyers could not know where to get information, even if it were available; and in the fourth place, powerful advertising and selling agencies are dedicated to the task of building up various types of irrationality in buyers. On the whole, however, we may conclude that with respect to many of the articles in common use, buyers do a "tolerable to fair" job of selection.

Without doubt, much of our productive energy is devoted to making and selling things which contribute little to the building of a good life. Much of it is spent in the production of style goods—gadgets, gee-gaws, things of no fundamental merit—in the creation of wants whose satisfaction adds little or nothing to human welfare. Much is wasted in working at cross-purposes, in advertising and salesmanship, in cudgeling and battering the consumer with specious appeals for consideration of distinctive flavors, qualities, and styles whose distinctiveness is largely a mirage. Yet, with all this waste of productive energy, the capitalist system has *worked*, has perhaps satisfied people's wants better than any other system that has yet been tried. No human institution can approach perfection.

Even if we assume that people are generally irrational, we cannot argue that therefore some other system will work better than capitalism. In a capitalist system we choose which industries and entrepreneurs shall survive by buying their products, by casting our "dollar votes"; in a socialist society we would do this, directly or indirectly, by voting at the polls. People would probably not vote any more intelligently than they now spend their money, and therefore socialism would not improve their situation in this respect. If people are generally irrational, they would not get on very well under any system.

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[8] Alfred Marshall, *Principles of Economics*, p. 9.

The assumption of the survival of the fittest. The assumption that competition in industry will result in the survival of the socially fittest may be criticized on various grounds. In the first place, we have already seen that all urban industry deviates more or less from pure competition, and to that extent does not necessarily winnow out the fittest business leaders. In the second place, Clay raises a question as to the exact meaning of the word "fit" in this assumption, but concludes that the "fitness" referred to is fitness to make money and produce wealth, not fitness to do anything else. The men who survive and come up to the top—the Goulds and Morgans and Rockefellers and Mellons and du Ponts—are "fit" only in the sense that they can accumulate money, perhaps by producing wealth, perhaps in other ways. Even if we assume that they gain their income entirely by producing wealth, they can be called the fittest, as Clay says, "only if the end of man is the production of material wealth. The distinctive feature of man is that he is a moral being; he can choose his end, and judge his 'fitness' by reference to that end. To justify free competition on the ground that it gives position and influence to the 'fittest' is therefore to choose the production of material wealth as the chief end of man. If any other end be chosen, for instance art, the religious life or the service of others, then free competition will stand condemned, because the survivors of the economic struggle are not conspicuous for love of beauty, piety or disinterested philanthropy. A St. Francis or a Stevenson (not Stephenson) survives by reason of his very unfitness to make money; the cathedrals of the thirteenth century are a great achievement just because their builders did not adopt the methods that bring wealth in a competitive society."[4]

The assumption of an association between wealth and social service. In a capitalist society, production is left to private entrepreneurs on the assumption that as a rule they can acquire wealth for themselves only by rendering a useful social service. Since the validity of this assumption was examined in the chapter on profits and in various other parts of this book, it will be sufficient here once more to state our conclusion that there is a rough validity in it, particularly in regard to smaller competitive businesses, such as farming and retailing. Yet there are many ways of securing wealth without rendering a commensurate service, and most of the great fortunes in America, as in other countries, have been partly unearned.

Even if we concluded that financial success is largely the fruit of unproductive or predatory activities, we would not necessarily be driven to prefer some other economic system. A socialist government, operated by entirely wise and enlightened people, could probably be run with less of such parasitism, but there are not many entirely wise and enlightened people.

In some fields of human endeavor, unfortunately, financial rewards are often inversely related to the quality of the productive work, and the "fittest"—those who are most generously rewarded pecuniarily—may be the ones who are willing to do shoddy work of no enduring merit. The artists who draw some of our popular comic strips earn incomes that would have dazzled Whistler, Corot, or Turner; some of the pulp magazine writers are paid more than Walt Whitman or Edgar Allan Poe ever received; Irving Berlin takes in each year more than Schubert was paid in his entire lifetime. This is not altogether a fault of capitalism, however, but rather a fault of human beings, as Hartley Withers says:

> Under it [capitalism] the value of our work, like everything else, is what it will fetch—that is, what we can get for it out of our fellows. If they

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[4] Henry C. Clay, *Economics for the General Reader*, pp. 375–376. By permission of The Macmillan Company, publishers.

are vulgar, tasteless and stupid we can sell them rubbish and grow fat on them, if we happen to be greedy rogues. The fact that many of them are vulgar, tasteless and stupid thus gives greedy rogues a chance of which they make ready use; and so the unpleasant sight is daily seen of greedy rogues battening on vulgar stupidity, and so getting for themselves all the power and influence that wealth brings with it. And then moralists naturally exclaim that there is dreadful villainy abroad, and that the laws ought to be made much stricter for catching and punishing it; and short-cutting reformers cry out that there is no remedy for such a system except its abolition and the substitution of a new way of rewarding people which shall not in any way depend on the price at which they can sell their work. But surely the true remedy, though a terribly slow one, is for the community to contain a smaller and smaller number of vulgar, tasteless and stupid people so that it shall grow continually more difficult for bad work to get a good price.[5]

If people want shoddy art, music, literature, moving pictures, and architecture, they will presumably get them under any other democratic system—socialism, for instance—as under capitalism. If they hired their painters, musicians, writers, and architects as public employees in a socialist economy, would they not get the same type of producers and products that they have now? Would they not cast their votes for the same stuff that they now spend their dollars for? Aside from the fact that the public taste for some rubbish has been developed by profit-minded advertisers who would not be at work in a socialist economy, it seems likely that the wants of the people would not be very different, and that they would demand and get somewhat the same kind of goods and services as they have now. The only way to avoid this would be to turn to some form of autocracy in which the people would not have much voice, in which they would be obliged to content themselves with something better than they really wanted; but there is no certainty that an autocrat would provide something better. There is some evidence that Russia is developing fine art, literature, music, and drama; but Germany and Italy, under Fascist domination, did not do as well as they did under capitalism.

The assumption of market price as a satisfactory indicator for production. In an earlier chapter we analyzed the function of market price in a capitalist economy, and concluded that to the extent that there is competition, the price system tends to direct the energies of society into the production of things most wanted by consumers; but this assumption, that market price is a satisfactory indicator for production to follow, is questioned by some critics. To the extent that there is competition and equality of incomes, the assumption has great validity; but to the extent that these two conditions are absent, the market price indicator does not operate effectively. A high price for nickel, for instance, does not direct social energies into the production of more nickel, because the nickel monopoly has a fence around the industry. We have seen that because of economic inequality, the goods produced do not afford the greatest possible total satisfaction, for the rich with their large incomes can appropriate for themselves goods which would satisfy far keener wants for people with small means. So the rich indulge their every trivial want and whim, while one-third of our people are actually undernourished and lack decent houses, clothes, education, and medical facilities.

Capitalism as a game

Many people assume that capitalism in its competitive aspects is a kind of competitive game, analogous to a race, in which the ablest of the contestants is likely to win; but a few critics, notably Frank Knight, have insisted that as a game it is played under rules which cannot be ethically defended. Ignoring the fact that most industries are more or less monopolized and that the monopolists refuse to allow any competitive players in their game—or at any rate any who are not more or less handicapped—we must concede that the game is not attractive to all the people who have to play it. According to Knight. "However favorable an opinion one may hold of the business game, he must be very illiberal not to concede that others have a right to a different view and that large numbers of admirable people do not like the game at all. It is then justifiable at least to regard as unfortunate the dominance of the business game over life, the virtual identification of social living with it, to the extent that has come to pass in the modern world."[6] No doubt the game *is* fun for most of the leaders, for those who are well equipped to play it and can hope to win, and perhaps for those who lack the cultural interests and resources needed for any other game; but for many others of the rank and file it is only so much drudgery, and, with the growing size and declining number of business enterprises, the number of leaders who can win is steadily diminishing.

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[5] Hartley Withers, *The Case for Capitalism,* pp. 35–36. By permission of E. P. Dutton and Company, Inc., publishers.

We must confess too that the game is not conducted fairly. In a fair race the contestants start even, at scratch; if the runners in a track meet started from points all the way between scratch and the tape, we should do but a shabby job of picking out fast runners, and our sense of sportsmanship would be outraged. But in the capitalist game, something like this is done. John D. Rockefeller, Jr., and J. P. Morgan start at the tape; others start from points well on the way; others—young men, some of them able, but without home or school advantages or capital or business connections—have to start at or behind scratch; and still others, most numerous of all, are not in the race at all. To secure a perfectly fair race in business we should have to eliminate all inequalities of inheritance, environment, and training; and this would leave little of capitalism, as the game is played.

Knight concludes his criticism with this penetrating paragraph:

> Thus we appear to search in vain for any really ethical basis of approval for competition as a basis for an ideal type of human relations, or as a motive to action. It fails to harmonize either with the Pagan ideal of society as a community of friends or the Christian ideal of spiritual fellowship. Its only justification is that it is effective in getting things done; but any candid answer to the question, "what things," compels the admission that they leave much to be desired. Whether for good or bad, its aesthetic ideals are not such as command the approval of the most competent judges, and as for spirituality, commercialism is in a fair way to make that term incomprehensible to living men. The motive itself has been generally condemned by the best spirits of the race.[7]

John Stuart Mill was similarly critical of the competitive struggle: "I confess I am not at all charmed with the ideal of life held out by those who think that the normal state of human beings is that of struggling to get on; that the trampling, crushing, elbowing, and treading on each other's heels, which form the existing type of human life, are the most desirable lot of humankind, or anything but the disagreeable symptoms of one of the phases of industrial progress."

critics

The vices of capitalist civilization

A few individuals in every capitalist country have protested against what they consider the ugliness, crudity, greed, and lack of culture of capitalist civilization. Nearly a century ago, John Ruskin railed at the capitalist civilization that was developing in England. "Let inventive men consider," he quotes from Carlyle, approvingly, "whether the secret of this universe does after all consist in making money. With a hell which means—'failing to make money, I do not think there is any heaven possible that would suit one well. In brief, all this Mammon gospel of supply-and-demand, competition, *laissez-faire*, and devil take the hindmost' . . . 'begins to be one of the shabbiest gospels ever preached.'" He had particular contempt for capitalist civilization as it was developing in America: "It is the fashion at present to talk of the 'failure of republican institutions in America.' . . . It is not republicanism which fails now in America; it is your model science of political economy, brought to its perfect practice. There you may see competition, and the 'law of demand and supply' (especially in paper), in beautiful and unhindered operation. Lust of wealth, and trust in it; vulgar faith in magnitude and multitude, instead of nobleness; besides that faith natural to back-woodsmen,—'lucrum ligna,'—perpetual self-contemplation, issuing in passionate vanity; total ignorance of the finer and higher arts, and of all that they teach and bestow; and the discontent of energetic minds unoccupied, frantic with hope of uncomprehended change, and progress they know not whither;—these are the things that have 'failed' in America."[8]

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[6] Frank Knight, *The Ethics of Competition*, Harper & Brothers, p. 66.
[7] *Ibid.*, p. 74.

Physical ugliness

That the capitalist world is unnecessarily ugly in many of its aspects can scarcely be denied, for when investments are made largely or entirely with a view to profits, artistic considerations must be ignored. So we have our ugly cities and towns, with business sections of standardized unsightliness or patchwork incongruity; with dirty, unsightly factory districts, built as cheaply as possible, and without any regard for artistic considerations, although here is where employers and workers must spend much of their lives; with dirty, crowded, unhealthy slums, where children are reared in the absence of most of the influences needed to build fine character; with speculative "additions" fanning out from the city limits, many of them built at minimum cost, sometimes in standardized designs and without benefit of architectural advice. So we have our roads, along whose length billboards scream the supreme merits of the various brands of cigarettes, tooth paste, and gasoline. So we have our denuded mountainsides, where once stood beautiful forests; our hot-dog stands and amusement shacks at every scenic point where private ownership is permitted; and our mining districts, where piles of slate and refuse litter the landscape, and long rows of identical shacks serve as homes for miners. There are beautiful residences in the cities, to be sure—a few for the rich and well-to-do—and some tolerably attractive homes for the upper middle class. Since profit-and-loss considerations do not dominate in building homes, there is some regard for aesthetic considerations, and a few of our great business buildings have also been designed for beauty by competent architects; but much of a typical American city offers a poor defense of the profit motive in capitalism.

Some of this ugliness is inevitable. Any factory district, under capitalism or any other system, will be littered with piles of coal, raw materials, and finished goods, and the chimneys must pour out more or less smoke; but such buildings as the Shredded Wheat factory at Buffalo and the Gruen Watch Company plant near Cincinnati prove that factories need not be as ugly as they generally are. It is probably significant that when federal, state, and municipal governments build, they usually put up artistic structures. Sweden's cooperative apartments and Vienna's municipally built apartments are widely known for their architectural beauty. Such buildings cost more than those commonly put up under private enterprise, but the world—and the United States in particular—can probably well afford to spend a little extra for aesthetic values.

Spiritual ugliness

Many critics of capitalism condemn it as being pervaded by a gross, materialistic spirit. This idea goes back more than two thousand years, at least to the time of Plato and Aristotle. Plato thought that "it is impossible for the citizens of a state to honour wealth, and at the same time acquire a proper amount of temperance; because they cannot avoid neglecting the one or the other," and he regarded "the unbounded acquisition of wealth" as a danger in his Republic. Aristotle railed at the men who "turn every quality or art into a means of making money," which he thought in general was an "unnatural" activity. This view prevailed to some extent throughout the Middle Ages, and even later. In *Queen Mab*, the poet Shelley expressed this idea eloquently, if somewhat too strongly:

> All things are sold: the very light of Heaven
> Is Venal; earth's unsparing gifts of love,
> The smallest and most despicable things
> That lurk in the abysses of the deep,
> All objects of our life, even life itself,
> And the poor pittance which the laws allow
> Of Liberty, the fellowship of man,
> Those duties which his heart of human love
> Should urge him to perform instinctively,
> Are bought and sold as in a public mart
> Of undisguised selfishness, that sets
> On each its price, the stamp-mark of her reign.

Not a few philosophers have insisted that the profit motive and the civilization built upon it are definitely unchristian. Jesus Himself lived a life of communism with His disciples: "All that believed were together, and had all things common"; He warned the people against covetousness: ". . . for a man's life consisteth not in the abundance of the things which he possesseth"; His only outburst of anger was directed at the money-changers, and He pictured no bright future for the rich: "A rich man can hardly enter into the kingdom of heaven." The early medieval churchmen were similarly critical of capitalist ethics and regarded the institution of private property as being rooted in sin. Clearly such religious doctrines cannot be the basis for a capitalist society in which covetousness is assumed to be the mainspring of nearly all productive activity, and private property is considered necessary to foster that motive. It is not surprising that Christianity has not "taken" better in capitalist countries.[9]

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[8] John Ruskin, *Essays on Political Economy*. The writer once knew a famous novelist who thought the United States a madhouse and went to Tahiti to live; he earned his living, however, by writing for the capitalist publishers of America. Many men, on the other hand, find joy in the very roar and clatter and hurry that drove this novelist to Tahiti.

It must be conceded, too, that the profit motive has little or no place in important areas of human life, in the home, where unselfish love must rule, or in the church, or in the lodge or college fraternity—in some of the institutions in which men and women apparently find their greatest happiness; nor is it by any means entirely dominant in the neighborly community, or indeed anywhere in the business world. Clearly the profit motive is not altogether a "natural" and inborn motive, for there was little of it in medieval times, and there is little of it in many societies today.

The capitalist spirit in war

The profit motive looks its worst in wartime. There is something unutterably depressing in the thought of soldiers undergoing every hardship, even to death, in order to defend a country whose people, safe and comfortable at home, are scheming to batten on the demands of war. As far back as the Revolutionary War, businessmen were piling up profits and many people were enjoying unprecedented prosperity at home while our soldiers were freezing at Valley Forge. While thousands of our Civil War soldiers were dying of disease and wounds, Carnegie and Rockefeller and Morgan and hundreds of lesser entrepreneurs were piling up fortunes made possible by war prices and war contracts, some of which were conscienceless and a few fraudulent; many farmers and laborers earned higher incomes than ever before; and those of the boys in blue who came back were given their full share of the nation's war debt to pay. The sordid story was repeated in both world wars. It is all right to require soldiers to risk their lives, but let no one interfere with profits.

This would be bad enough if the soldiers were really fighting for "home and country," for the interests of all the people at home; but in many cases they find out later that they have been fighting only for a few imperialist interests. As Anatole France once said: "One believes he is dying for one's country—and one dies for industrialists." In our Revolutionary War, the soldiers were indeed fighting for freedom, and the War of 1812 was a just war. The Civil War was fought, according to Charles and Mary Beard, as much to subject the people of the South to the tariff as to free the slaves. Union troops died to enhance the profits of New England manufacturers; Confederate soldiers, in a vain effort to prevent this and to bolster up the power of a few wealthy slave owners.

"Boundless acquisition"

Acquisition is the motive behind economic activity. Rather logically, there are no absolute limits to it, for the capitalist system exercises a psychological compulsion to boundless extension—to "the unlimited acquisition of money," as Aristotle expressed it. Activity in the capitalist system is determined no longer by the needs of any or all classes, but only by the possibility of making profits. When consumers' wants are satisfied, our indefatigable businessmen set themselves resolutely to the task of creating new wants, for good things or baubles, so that they may continue the game. To the extent that the struggle is competitive, it does not end when the contestants have acquired enough for a good life or even an extravagant life; they must continue indefinitely until heart disease takes them away for a long rest. We smile contemptuously at the poor heathen who are content to live from day to day, with no thought of accumulating goods for the future; but we see not the humor, or rather perhaps the tragedy, in a contest which does not end when it is won.

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[9] See William Temple, *Christianity and the Social Order*.

The motive of economic activity is acquisition in terms of money—"making money," in popular phraseology. Successful businessmen have the outward indexes of reputability—fine houses, streamlined cars, expensive raiment; they can travel far distances in comfort and style; they have the power and honor and envy that make life sweet. Since so much that is sweet goes with business success, many businessmen become so lost in the pursuit of money—which should be only the means to the good life, rather than the end—that they forget the end itself.

The indefinitely expansive character of capitalism has indeed brought us great material wealth on which we have built a civilization of physical comfort that has served as the basis of more kindness and humanity than the world ever knew before. On the other hand, the supremacy of business interests over all other values has meant, in some respects, low cultural standards. Sombart points the moral in an eloquent passage:

> Wherever acquisition is absolute, the importance of everything else is predicated upon its serviceability to economic interests: a human being is regarded merely as labor power, nature as an instrument of production, life as one grand commercial transaction, heaven and earth as a large business concern in which everything that lives and moves is registered in a gigantic ledger in terms of its money value. Ideals oriented upon the value of human personality loosen their hold upon man's mind; efforts for the increase of human welfare cease to have value. Perfection of the business mechanism appears as the only goal worth striving for; the means become an end. The vague notion of progress comes to include only such developments as advances in technology, reductions in costs, increase in briskness of trade, growth of wealth.[10]

The capitalist spirit in advertising

Some critics of the present order point to the vulgarity of the capitalist spirit as it appears in the advertising business. Our newspapers and most of our magazines, so the argument runs, are more a medium for selling goods than for purveying news, and as a consequence are crammed with puffing, bragging and frequently exaggerated or wholly false claims of merit. The radio—"the American patent medicine show"—provides a steady hum of generally execrable music and silly dialogue, interspersed at fifteen-minute intervals with advertising. To reach and sell to the greatest possible number of buyers, advertising must of course aim low, must appeal to the relatively numerous but untutored masses. Finer things—books, for instance, and good music—are seldom advertised. Everyone is exposed to the poor, the cheap, the blatant, until many cease to be shocked by them. Even college students generally see nothing wrong with magazine and radio advertising. Trained—or perhaps we should say calloused—by exposure to the tawdry wares of the advertisers, they can conceive of nothing better.

The externalization of our lives

One of the important aspects of the pecuniary measure of success is seen in the "externalization" of our lives. We are more anxious to *seem* than to *be*. We strive for baubles and geegaws and gimcracks, good clothes and shiny cars, rather than for contentment, fundamental culture, and appreciation of real beauty. Not knowing how to spend our time, we take what satisfaction we can in spending our money. Culture is not ignored, indeed—not with thousands of cultural lectures by celebrated experts in that subject, with thousands of women's clubs meeting every week; but the idea persists that culture is "something that can be acquired by anyone who has the cash, that it does not arise naturally out of the good life but is something that can be plastered on an impoverished life, in short, that it is a cosmetic."[11]

The capitalist spirit and other systems

Let us concede, for the sake of argument, that the spirit of capitalism is materialistic. Is this materialistic spirit worse than, let us say, the religious spirit that dominated the Middle

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[10] Werner Sombart, in *Encyclopedia of the Social Sciences*, vol. iii, p. 197.

[11] See Lewis Mumford, "The City," in Harold Stearns (ed.), *Civilization in the United States: An Inquiry by Thirty Americans.*

Ages? The religious spirit could be horribly cruel, as the tortures of the Inquisition show; and it was hostile to intellectual freedom and scientific advancement. Furthermore, if we could see clearly into the lives of the people of that period, we might find the acquisitive spirit present in a grosser and meaner form than it takes today. The worship of wealth is not as new as many seem to assume. As Mark Twain once said: "The human race has always adored the hatful of shells, or the bale of calico, or the half-bushel of brass rings, or the handful of steel fish-hooks, or the houseful of black wives, or the zareba full of cattle, or the two score camels and asses, or the factory, or the farm, or the block of buildings, or the railroad bonds, or the bank stock, or the hoarded cash, or—anything that stands for wealth and consideration and independence, and secures to the possessor that most precious of all things, another man's envy."[12]

If we turn to Fascism, we find less of the materialistic spirit, for the Fascists are assumed to work for the state rather than for their own selfish material interests; but we find more of something much worse than materialism—the brutal ambition for war and conquest. Communism in Russia has apparently lost much of the idealism with which it started. If a socialist state could preserve democratic control, there might be a finer spirit than capitalist materialism, but no such state has ever existed.

The wastes of capitalism

Much has been said and written about the wastes of capitalism, and the indictment is to some extent just; but the word "waste," like "production," is a slippery term, so difficult to define that it can scarcely ever be given a precise meaning. It is often said that the labor devoted to the production of intoxicating liquors is "wasted" because mankind loses more than it gains through their use. Once we start down that road of definition, however, we shall soon be in grave difficulties, for the same thing can be said, with varying measure of truth, of coffee, tea, candy, tobacco, cosmetics, jazz, half the books published. Truly an all-wise dictator could save much labor by restricting consumption to things that are good for people; but the fact that capitalism generally provides what people want should not be rated a vice of that system. We must take people for what they are, with their obfuscations and irrationalities. If our capitalist machinery is responsible, through advertising, for some of those irrationalities, so also might a dictator who was not altogether wise and beneficent instill in his people such irrationalities as suited his ambitions.

With the warning that the term waste is impossible of exact definition, we shall proceed to use it because there is no other word more precise in meaning. As we have already seen, natural resources have been wasted prodigally: timber, coal, oil, natural gas, the soil itself. This waste of resources is a vice natural to capitalism, for in their exploitation there is no identity of private and social interests. For this reason natural resources should be publicly owned. Here socialism is definitely superior to capitalism.

The waste in competition. The competition essential to capitalism is in itself wasteful in various ways. Many men who have not the necessary qualities enter every competitive business, and many lose their savings in a few years. The exact rate of failure cannot be stated, but it is certainly fairly high in retailing, and almost as high in manufacturing and wholesaling. Such waste as this is inevitable in an economy of free enterprise. If men are to be free to choose their own work, some will inevitably fail; but it may be well that those who lack the qualities needed in a business should fail, for if they did not, many of our enterprises would be inefficiently operated. The winnowing process of capitalist competition is wasteful, but it tends to sift out the able men; and any system designed to eliminate this waste would have other wastes, possibly quite as serious. In a socialist economy there would be fewer failures, presumably, but managers might be less efficient and there might be less freedom in the choice of occupations. In a capitalist regime, goods cannot be produced unless they are worth in the market at least as much as they cost; but in a socialist or communist state some goods might be produced at a loss, the state paying the deficit.

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[12] Mark Twain, "Does the Race of Man Love a Lord?" *Writings of Mark Twain,* vol. xxiv, p. 269.

This would be justified for such services as education, recreation, protection of public health, and a number of others; but in the case of ordinary consumers' goods it would represent a waste of productive resources, a social

The waste in advertising and salesmanship. A second serious waste of capitalism is in advertising and salesmanship. As Stuart Chase graphically pictures it:

> The advertising industry, viewed from an aeroplane, would be seen to consist of some 600,000 workers—writing copy, canvassing for clients, designing layouts, painting pictures, engineering campaigns; supported by printers, compositors, paper makers, chemical workers, lumber jacks, railroad men, carpenters, sign painters, electricians, lithographers, bill posters, wood workers, paint makers, mail clerks, letter carriers, telephone operators, stenographers, bookkeepers, psychologists, and efficiency experts—to name only a few. Advertising keeps the whole 600,000 busy. If they lived in Denmark—where advertising is restricted—they would have to turn to some productive occupation. In other words, the industry reaches down into the ranks of the gainfully employed, picks up a half million odd workers, and says to them "Now shout! and furnish the paper, ink and paint for shouting."[13]

To these 600,000 workers we might add a few thousand teachers of advertising and of the psychology of advertising whose function is to find and teach more effective ways of "shouting." Chase estimates that about 90 per cent of the productive energy employed in advertising is wasted. The total amount spent annually for advertising is only a little less than the total endowments of all our endowed colleges and universities.

The waste of the services of the advertisers and of the others who support them constitutes only a small part of the waste involved in our free-for-all system of advertising. To get the total, we should have to add the waste of the energy and capital that are used in the production of thousands of commodities of inferior quality, goods which are sold to the public through aggressive and sometimes mendacious advertising. Checking differences in the quality of goods of any kind, we must conclude that a fairly large proportion of all our producers are turning out inferior stuff and selling it to people who put too much trust in advertising.

To the extent that advertising is used to promote style changes and to make people discontented with what they have, it is worse than pure waste; it is largely destructive. Style changes, as Slichter has said, "may be regarded as a device for destroying the value of goods by rendering them obsolete"; this means that advertisers are persistently destroying the value of much of the women's clothes, and to a lesser extent of men's clothes, as well as that of scores of other products bought by consumers. Naturally the intent of a considerable portion of our advertising is to make consumers discontented and unhappy, even to humiliate them with slighting references to "dish-pan hands" and other evidences of poverty; the illustrated advertisement picturing "one-dress Beulah" in various embarrassing situations, which ran for weeks in a New York newspaper, could hardly have made our thousands of "one-dress Beulahs" and Gretchens very happy. A gang of hoodlums who stood on the street corner and made slighting remarks about the dress and appearance of the passersby would be promptly arrested; but advertisers do something a little like this all the time.

Advertising would be less wasteful if there were not such a vast number of brands and trade-marks, many of which are created by the advertisers. A former director of the United States Bureau of Standards estimated that there were 10,000 brands of wheat flour, 4500 brands of canned corn, 1000 brands each of canned peaches, canned salmon, and canned peas, 500 brands of mustard, and 300 brands of pineapple; but of course no one store or even any one section of the country handles all the brands. An investigator in Milwaukee found dozens of brands of canned milk, 142 brands of coffee, 95 of tomato juice, 225 of canned peas, and 107 of peanut butter. There are some 50,000 patent medicines on the market, most of them useless, and some definitely harmful; the consumers' bill for these runs to about a billion a year.

If all the myriad of brands represented

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[13] Stuart Chase, *The Tragedy of Waste*, p. 112. By permission of The Macmillan Company, publishers.

really different kinds of goods, the high cost of marketing them all would be compensated to some extent by the extraordinarily wide selection available to consumers; but the number of really different varieties and qualities constitutes only a fraction of the total number of brands. There are not 1000 varieties and qualities of canned peaches; there might be as many as a dozen or a score that could be distinguished by consumers, but the other 980-odd brands represent imaginary differentiation, which is largely waste. A socialist economy could save a great deal here.

Salesmanship involves competitive waste just as advertising does, and in some businesses—the insurance business, for example—this waste amounts to impressive figures. We have something like 500,000 insurance agents trying to persuade us to take out insurance policies, ringing our door bells, pouncing upon us unawares, and giving us their sales rigmarole. A fair percentage of the cost of insurance goes to pay these men for their efforts. So too we are pursued by salesmen of automobiles, real estate, stocks and bonds, each one trying to convince us that his wares are the best; and our colleges train men and women for careers in salesmanship—and then we wonder why the lower classes buy more than they can afford!

Duplication of plants and services. A capitalist economy evidences great waste in the duplication of plants and services. Except during war, we have too many railroads, too many service stations, too many retail stores, too many farmers, too many salesmen, too many lawyers—too many duplicating plants and services of various kinds. Many important cities are connected by two or three railroads, whereas this service could be rendered much more cheaply by one road. In the United States as a whole there are 1,300,000 retail dealers selling goods that could probably be sold more cheaply by half as many. Groceries, milk, and other commodities are delivered by a dozen cars sputtering up and down the streets, whereas one could handle all deliveries much more cheaply; in many towns and cities several taxis representing different companies meet every incoming train, although there may be enough passengers for only one car.

Walter Polakov estimated in 1933 that the woolen industry, even at a peak wartime demand, ran at 70 per cent of capacity; that the coal industry could produce more than twice the tonnage actually needed; that the boot and shoe industry, even in prosperous years, produced at only half its capacity; that our clothing factories were about 45 per cent larger than necessary; and our printing plants from 50 to 150 per cent overequipped.[14] Before the outbreak of the Second World War, there were probably nearly 2,000,000 more farmers than were needed to produce the farm products then produced; and the automobile manufacturers had the equipment to produce several million cars more than could be sold. In its study of America's capacity to produce, the Brookings Institution estimated that even in the roaring prosperity of 1929, industrial production was only 81 per cent of capacity.

Some of these figures must be accepted with reservations. The "productive capacity" of most industries cannot be given in precise figures, because some plants are not up-to-date and could be used only if prices were high enough to cover the high costs involved. Yet it is unquestionably true that there is a great deal of excess capacity in most industries.

Such wastes as these might be less in some other economic system, such as communism or socialism; but any other system would almost certainly develop other wastes, perhaps equally serious. Moreover, under capitalism we have reduced some of these wastes considerably; the worst forms of misrepresentation in advertising, for instance, are less common than they once were, and the waste of natural resources has been reduced in recent years.

The waste from idleness. Voluntary unemployment in the form of parasitic idleness is also pointed out as a serious vice of capitalism; Stuart Chase estimates the idle rich and hoboes in this country at 600,000. Here again, however, we are not sure that capitalism is more wasteful than other forms of economy. The bureaucracies and the Gestapos and the armies of Fascist countries certainly represent a far greater waste of human talents than our parasitic idlers.

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[14] See Robert Morss Lovett, and others, *Recovery Through Revolution*, p. 428.

The waste from business depressions. The capitalist economy is subject to periodic depressions and to consequent unemployment of men and capital which represents a tremendous waste of productive power. This waste, during the worst years of the recent depression, was estimated to represent a money value of 20 billion dollars a year. This waste is natural to capitalism and seems to be growing more serious because capitalism is working less efficiently. Unless some way can be found to reduce unemployment below the levels of prewar years, it may be necessary to shift from capitalism to some other system. Any other economic system—socialism, Fascism, or communism—would have a certain amount of unemployment because of labor shifts of various kinds, but there should not be any such volume as the United States had in the Great Depression.

The waste in speculation. Capitalism involves a great waste of human energy in speculation and gambling. The quest, in a capitalist society, is for profits. Profits are sometimes made in speculation and gambling in land, stocks, grain, and other commodities; and it is therefore not surprising that a vast amount of energy should be spent in efforts to "get something for nothing." Some speculation, as we have seen, is necessary and productive, because in a changing and dynamic economy certain risks have to be assumed by someone; but we are referring here to speculation engaged in for its own sake—perhaps better termed gambling. The total human energy and capital wasted in this country each year has to be measured in billions.

The waste in irrational consumption. The most serious waste in our economy is perhaps in uninformed and irrational consumption, but this has been discussed in the chapter on human wants and utility. Consumers might be better *informed* under socialism, for there would be no powerful business interests seeking profits by misrepresenting goods; but human *rationality* would presumably be about the same no matter what the form of the economy.

QUESTIONS

1. What are the assumptions of capitalism, as outlined by Clay? What criticism can you offe to each one?
2. In what respects is the capitalist world ugly in its physical aspects? Do you think that any medieval city was more beautiful?
3. In what fields does the quest for money return often lead to shoddy work?
4. How has the capitalist spirit brought "externalization" of our lives? Did the feudal spirit d something quite as bad?
5. What are some of the wastes of capitalism? Which do you consider the worst? Why?
6. Why is capitalism inevitably wasteful of natural resources? What is our present policy with respect to nearly all the land still owned by the government?
7. It is sometimes asserted that people have not the rationality needed for the successful operation of the capitalist system. Would irrational people be able to operate any other system any better?
8. Criticize capitalism as a game.
9. Discuss the argument that capitalism is antithetical to Christianity. On the other hand, capitalism has made possible the great wealth which has led to kindness and generosity. Are these not important aspects of Christianity?

Chapter 37.

An Appraisal of Capitalism: Business Control

In the ancient world, the emperor, king, pharaoh, or inca, together with his army and other followers, usually dominated the economy completely; in the medieval world, the feudal lord, or in some cases the church, was the dominant power. Under capitalism, however, powerful business interests largely dominate the economy, politics, and, to some extent, the social and cultural institutions, ideals, and traditions. Controlling the business economy—the jobs and the money—these business leaders are able to exercise a considerable measure of control over every field of living.

It is often argued that the democracy which Americans prate about is largely an illusion, that we have merely shifted from the rule of princes to the rule of capitalists. The argument runs somewhat as follows: Political representation can be truly democratic only if it is based on economic democracy—reasonable equality of wealth—and this we do not have. To an extent that is little realized by most people, so the argument runs, a small group of wealthy men control our lives; indeed, so clear is their domination that many political scientists commonly refer to them as the "ruling class." Before the election of Franklin D. Roosevelt, it was commonly said that no President had been elected since the Civil War who was strongly opposed by "big business."

That business, particularly big business, exercises a great measure of control over our lives cannot be questioned. As Henry S. Dennison has said: "The basic pre-supposition that business can be considered as an entity separate from government is wrong. . . . In the modern world a large number, often a considerable majority of the citizens, spend the most significant hours of their lives as part of the business structure. In so far, therefore, as business governs the lives of its people when they are working for it, business is, itself, a government within a government. Its possibilities of affecting the well-being and self-respect of its people for better or worse cover just exactly the ground which the democratic hypothesis claims as the primary and essential field of government."[1]

Occasionally businessmen themselves express a similar opinion. Years ago William Randolph Hearst declared: "We still maintain a republican form of government, but who has control of the primaries that nominate the candidate? The corporations have. Who controls the conventions? The corporations. Who controls the machinery of elections? The corporations. Who own the bosses and the elected officials? Are they representatives of the people or of the corporations? Let any fair-minded man answer the question truthfully. If the corporations do all this—and they surely do—can we any longer maintain that this is a government by the people? It is a government by a distinct class."[2]

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[1] Temporary National Economic Committee, *Hearings*, Pt. 30, p. 16257.

F. Townsend Martin puts the case even more strongly: "It matters not an iota what political party is in power, or what President holds the reins of office. We are not politicians or public thinkers; we are the rich; we own America; we got it, God knows how, but we intend to keep it if we can, by throwing all the tremendous weight of our support, our influence, our money, our political connections, our purchased Senators, our hungry Congressmen, our public speaking demagogues into the scale against any legislature, any political reform, any presidential campaign, that threatens the integrity of our estate."[3]

Martin's statement may not have been very far from the truth at one time, although it is of course an exaggeration when applied to present-day America. At any rate, in any capitalist society business is a great power, often dominant. Whether the dominant group is composed of 13 families (Senator Joseph O'Mahoney's figure) or of 60 (as reported by Ferdinand Lundberg and by Secretary of the Interior Harold Ickes), or 30,000 men (*Fortune's* estimate) is not very important; it comprises an extremely small proportion of the people—about one in 4000, at most. How can this be? How can so small a group dominate the rest, when every man has a vote and has rights and privileges and immunities guaranteed by the Constitution?[4]

Organization and integration of big business

Big business is powerfully organized and integrated. We have already seen that the corporation itself concentrates power in a few hands, thus enabling a few officers and directors to control vastly more wealth than they could in an individualist economy; we have seen that giant corporations are tied in with each other and with banks through interlocking directorships, interlocking stock ownership, and in other ways. But this is only part of the picture. Business interests in practically every line of production are organized into state and national associations, many of which maintain permanent offices in Washington. Of some 389 national organizations which maintain permanent representatives in Washington, about half are businessmen's associations.

The more powerful of these associations maintain offices staffed by men and women who are specialists in the various kinds of work necessary, one of which is lobbying. Among the most important such organizations are the Edison Electrical Institute (representing billions of dollars in the electrical industry), the Association of Life Insurance Presidents (representing some 28 billions of insurance assets), the Association of American Railroads, the American Iron and Steel Institute, the American Petroleum Institute, the American Tariff League, the National Lumber Manufacturers' Association, the National Coal Association, the Copper Institute, the National Association of Wool Manufacturers, the National Association of Cotton Manufacturers, the American Merchant Marine Institute, the Navy League, the Air Transport Association, the American Bankers' Association, the Investment Bankers' Association of America, the American Newspaper Publishers' Association, the Sugar Institute, the National Dry Goods Association, the National Retail Federation (representing largely the chain and department stores), and the National Association of Retail Druggists.

But the integration of business is even tighter than this list suggests, for some 3000 of the most powerful corporations in the country are organized into the National Association of Manufacturers, which represents a total of between 30 and 40 billions of corporate wealth. The N.A.M. is the "voice of American industry," and a stentorian voice it is, with its backing of almost unlimited funds; it spends annually as much as a million and a half for propaganda and lobbying.

Business interests are also integrated through the Chamber of Commerce of the United States, a federation of 1500 commercial and trade associations; its members include more than 7000 of the most important corporations, firms, and individuals in the country. The Chamber of Commerce—the Washington press agent of organized business—"usually operates more as a force for discovering and expressing business opinion than for putting pressure on Congressmen and Senators, leaving that role, for the most part, to its constituent members acting independently or through other groups"; nevertheless it engages to some extent in lobbying, and spends large amounts on propaganda. When a bill that it opposes appears in Congress, it notifies its members throughout the country and asks them to write or telegraph their Senators and Representatives, asking them to vote against it.

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[2] George Seldes, *You Can't Do That*, p. 211.

[3] John McConaughy, *Who Rules America*, p. 312.

[4] On this subject, see Temporary National Economic Committee, "Economic Power and Political Pressure," *Monograph No.* 28.

Generally sympathetic with the business point of view are a number of other influential organizations. The American Bar Association has often assumed the role of trustee of "American institutions," particularly of the Constitution; and since lawyers are often closely associated with business, the Bar Association usually sees eye-to-eye with business interests and sometimes exerts strong influence in Washington. The American Farm Bureau Federation, which for the most part represents the big farmers, frequently supports big business, as does also the Associated Farmers, a California organization which represents mainly wealthy businessmen, not farmers.

There are other forces in Washington, it is true, other organizations not under business control, some of them generally hostile to business. The great labor organizations—the A.F. of L., the C.I.O., and some of the constituent unions—maintain Washington headquarters, as do also many philanthropic and professional organizations. The various agencies, departments, and bureaus of the government, including the Congress, are assumed to represent the people as a whole, and not business alone; but business organizations hold the preponderance of power because of their generally longer life or greater staying power, their cohesion, their invisibility, and their greater resources. These advantages demand some consideration.

Staying power of business organizations

Business associations have longer life, greater staying power than most other pressure organizations, or the government itself. Most of our important corporations have been in business, and in politics, for decades, under able leadership which frequently remains unchanged for many years. The Washington lobby of the National Association of Manufacturers has a relatively stable staff of men, picked for their astuteness and their experience in lobbying tactics, some of them lured from government offices by higher salaries. With its vast resources, the N.A.M. can usually hold these men as long as it wants them, and can give them time to become thoroughly experienced in the work they do. In the government itself, on the other hand, Representatives are elected for only two years, Senators for six; thus every two years the personnel of Congress changes, in some cases enough to put another party in power. Accordingly, in any tussle with Congress or with congressional committees, the experts from the business pressure groups have the advantage of experience, and perhaps also of shrewdness, and ability, as well as the very great advantage of being backed by fat checking accounts. The chiefs of some of the government departments and bureaus may be changed with a shift in party control; subordinates in these bureaus may enjoy security of tenure, but some of the most efficient leave government service to work for business associations and carry with them a knowledge of government functions which may be of great value in their new posts. Business organizations also have greater staying power than labor or farmer lobbies. Labor unions have their ups and downs as employment fluctuates and as interunion rivalries flare up and die down, and farmers have never been well organized, although recently they have done much better. Business associations are on the job all the time.

Cohesion of business organization

Business, particularly big business, is far more tightly organized than any other economic interest. Through the corporation and the various intercorporate connections, big business concerns are closely integrated; all businessmen pursue the same end—profits—and most of them hold the same general economic and political philosophy; and as a result they stick together in their pressure organizations better than other economic groups. Labor has split into three groups—the A.F. of L., the C.I.O., and the railway trainmen—which sometimes fight one another about as bitterly as they do the employers. Several million isolated farmers likewise fail to secure the same cohesion as business associations; in fact, there is a considerable amount of friction and disagreement among the various agricultural organizations—the Farm Bureau, the Grange, and the Farmers' Union. The farmers' organizations often represent business interests, in some cases more strongly than agricultural interests, just as many individual farmers follow business leads on economic and political questions, even when it is contrary to their own economic interests. Small business, similarly, usually follows big business in its philosophy, although its interests are by no means identical with those of big business. It is big corporate business—chain stores, for instance—that is crowding small business off the map; yet the average small merchant mouths N.A.M. slogans with the conviction and fervor of a crusader.

Invisibility of business organizations

A great advantage enjoyed by business in its propaganda and lobbying activities is its invisibility—it can spend millions without any publicity whatever. As Donald Blaisdell says:

> Government expenditures are made out of public revenues, and their use is subject to public scrutiny at all times. Hence, business, as part of the public, is able to challenge and keep to a minimum Government expenditures for propaganda purposes. Government, by means of the taxing power, congressional investigation, and use of anti-trust statutes, and so forth, can to some extent limit business' expenditures for propaganda purposes. Compared to the glare of publicity that surrounds Federal expenditures, business carries on its activities in a dim and comforting gloom. In the last analysis it receives its funds from the public, allegedly for services rendered. Yet, because propaganda and lobbying expenditures are included in the cost of doing business, the public pays for these expenditures, and it pays for them not once but twice. As a cost of doing business they are deducted before figuring the net income out of which dividends are paid and against which income taxes are levied. This public quality inhering in business funds is to a large extent ignored. Rarely are business expenditures examined from the viewpoint of their effect on the general welfare. Rarely are even the total amounts expended made known, and almost never is there published an analysis of the way in which the total was distributed. Admitting the advisability of the existing strictures on the use of Government funds, it seems equally important, or more so, that they should be applied to the political expenditures of business.[5]

Resources of business organizations

Vastly greater than the resources of labor or farm organizations, or those that the government can use at any given point of contact, are the resources of organized business. Such an organization as the N.A.M. can pour money out like water to elect the right political candidates, to have its way in legislation, and to hire lawyers, lobbyists, scientists, or any legal or technical help it wants. And lavish propaganda expenditures, although paid for by the public, are known only to a very few people. The National Electric Light Association propaganda campaign, for example, which cost some 25 or 30 millions, paid by consumers of electricity, happened to come to light and was investigated by the Federal Trade Commission; yet probably not as many as 5 per cent of the people ever knew the actual facts.[6] The textbook material offered free by the N.A.M. has received practically no notice in the press, for most newspapers do not give much space to scandals in high business circles.

Big business in politics

Not only do influential business interests seek to mold public opinion on economic questions, but they work hard and effectively on Congress, the President, and every agency of the government. Rich businessmen provide almost all the campaign expenses of both major parties. In the presidential campaign of 1928, the following contributions were made to the Republican campaign chest:[7]

Walter H. Aldrich, U. S. Smelting Co.	$ 25,000
George F. Baker, Jr., banker	27,000
W. O. Briggs, Briggs Body Co.	25,000

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[5] Temporary National Economic Committee, *Monograph No. 26*, pp. 19–20.

[6] On the NELA campaign, see Jack Levin, *Power Ethics.*

[7] Ferdinand Lundberg, *America's 60 Families*, p. 180.

Edward H. Cary, Pullman Car Co.	25,000
Walter P. Chrysler	25,000
William A. Clark, Jr.	25,000
George W. Crawford, Mellon interests	25,000
William H. Crocker	25,000
William N. Cromwell	25,000
Clarence Dillon	25,000
Alfred du Pont	25,000
W. C. Durant	25,000
George Eastman	25,000
Cyrus Eaton	25,000
Harvey S. Firestone	25,000
Fisher Brothers and Fisher Body Corp.	100,000
D. N. Goodrich	25,000
Daniel Guggenheim	25,000
Harry E. Guggenheim	25,000
S. R. Guggenheim	25,000
Charles Hayden	25,000
E. F. Hutton	25,000
Otto Kahn	25,000
S. S. Kresge	25,000
Richard B. Mellon	25,000
S. W. Mellon	25,000
Eugene Meyer	25,000
Jeremiah Milbank	25,000
J. R. Nutt	26,000
John D. Rockefeller	25,000
John D. Rockefeller, Jr.	25,000
Julius Rosenwald	50,000
Mortimer Schiff	25,000
Charles M. Schwab	25,000
Alfred P. Sloan, Jr.	25,000
Herbert N. Strauss	25,000
Arthur Whitney	25,000
Estate of P. A. B. Widener	30,000
Harrison Williams	25,000
John N. Willys	25,000
George Woodruff	25,000

The Democratic fund was similarly enriched by contributions from men of great wealth, but in somewhat smaller amounts. Some men give to both political parties, and some officers of a corporation give to one party and some to the other, so that however the vote goes they will have credit for the result and can demand appropriate consideration from those elected.

In at least a few instances, wealthy financiers have gone after political influence in a more direct way. In 1929, J. P. Morgan and Company gave a number of important political figures, among others, the right to buy shares of several corporations at a price considerably lower than the market price—the equivalent of a gift, inasmuch as the buyers could immediately sell at the market price and pocket the difference. Such gifts were made to the Secretary of the Navy, a former Secretary of War, two former Secretaries of the Treasury, the chairman of the Democratic National Committee, the wife of the Agent General for Reparation Payments, the Republican National Committeeman for New York, a future United States Ambassador-at-Large, the personal financial adviser of the President of the United States, and an ex-President—presumably in the hope that they would be properly appreciated.[8]

Business influence in foreign policies

Business interests have even more influence in foreign than in domestic policies. Our State Department has always been rather subservient to powerful business interests, just as the Foreign Offices of some European countries have. That is one reason why England backed Franco in Spain and for some years supported Mussolini in Italy and Hitler in Germany; and it is one of the reasons why the United States followed a pro-Fascist policy with respect to Franco and sold steel and oil to the Japanese government for several years prior to the outbreak of the Second World War. A few powerful interests, particularly the Standard Oil Company, have largely determined our relations with Mexico.

Business interests and the press

Business control of public opinion and of politics—not absolute, of course, but fairly strong until recently—has been due partly to its influence on many of our large newspapers and the radio, the most important avenues to the public mind. Most people read little but newspapers and listen a great deal to the radio, both of which reflect the altitudes of business leaders.

Most of the larger newspapers are tied in with the ruling business hierarchy in various ways. For one thing, such newspapers *are* big business, carried on largely for profit. Such a paper may represent an investment of 20 millions or more; it employs thousands of workers, and it usually makes profits. A celebrated newspaper editor once said that the newspaper business had "degenerated from a noble profession to an 8 per cent investment." On the basis of evidence he has accumulated, George

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[8] *Ibid.*, pp. 235–237.

Seldes concludes that nine men control many of our largest newspapers, and that eight of these men are closely tied up with dominating business interests.

Not only are big newspaper owners wealthy capitalists in their own business, but some of our wealthiest industrial capitalists have invested in newspapers. The Rockefellers at one time owned a number of newspapers and magazines but have now disposed of most of their newspaper interests, perhaps because they find that they can secure support from this source in other ways; the International Paper and Power Company not long ago had important financial interests in several papers; J. P. Morgan and Company have financed newspaper purchases at various times—particularly through Frank Munsey, the great newspaper magnate who bought a number of newspapers —and eliminated some that were unfriendly to the Morgan company; Thomas Lamont, a Morgan partner, was for years a director of the Crowell Publishing Company, which publishes the *American Magazine*, the *Country Home*, *Collier's Weekly*, and the *Woman's Home Companion;* the Wanamaker family once owned the Philadelphia *Record* and the Philadelphia *North American;* Sewell Avery, president of Montgomery, Ward and Company and a director in other large industrial corporations, is a director of the Chicago *Daily News;* the Harkness and Harriman families are financially interested in Time, Inc., which publishes *Fortune*, and the Harrimans are also stockholders with Vincent Astor and John Hay Whitney (Standard Oil) in *News-Week* magazine; John Jacob Astor is reported as the largest stockholder in the London *Times;* the du Ponts own several newspapers in Delaware; the McCormick and Patterson families have heavy interests in the newspaper business, particularly in the reactionary Chicago *Tribune*. All the connections linking business and the press are too numerous, however, to be traced further in this book.[9]

Business also exerts great influence on the press through advertising. Newspapers and magazines serve in a dual capacity: as dispensers of *news* and as dispensers of *advertising;* and from the business angle the second function is the more important, for from it are derived most of the revenues of the press. As dispensers of the news, the papers are in some respects extraordinarily efficient, not only in the vast amount and wide distribution of news they carry, but in the speed with which it is brought to the reader and the accuracy with which most of it is presented. The American press is often held to be the freest and best in the world.

As dispensers of advertising, the newspapers and magazines naturally take a friendly interest in the advertisers, including the professional advertisers who are strongly organized on a national basis, and many of the great corporations of the country and the trade associations of which they are members. It is easy for the press to take this friendly, cooperative attitude toward business concerns which spend millions every year for advertising space—the patent medicine business alone is estimated to spend more than 300 million dollars a year—and to show it whenever attempts are made in Congress to protect consumers from adulteration and misrepresentation of goods.

The power exercised by the press is even greater because many of the newspapers are members of the American Newspaper Publishers' Association and of the Associated Press, which is the largest of our news-gathering syndicates. When Marshall Field III established two liberal newspapers, the Chicago *Sun* and *PM*, the Associated Press refused to let him subscribe to its services, presumably because other Chicago papers did not want more competition and because most of its other big subscribers did not want more liberal papers. The Department of Justice then filed an anti-monopoly suit against the Associated Press, and the Supreme Court ordered the A.P. to alter some of its practices. Significantly, many of the newspapers reported the Supreme Court decision as if it were a victory for the A.P.

A few of our large newspapers are not only conservative but so definitely Fascist in their attitude that some students of Fascism have named several of them as constituting a "Newspaper Axis" and have insisted that if Fascism comes to the United States it will have strong newspaper support.

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[9] See *ibid.*, chaps. 7, 8.

Suppose, for the sake of argument, we concede that most of the big newspapers are to some extent controlled by business interests; is there any evidence that they exert much control over the views and votes of the people in favor of big business and its policies? In some cases the press apparently has only a modest influence. In the presidential campaign of 1936, between 70 and 80 per cent of our papers opposed Roosevelt for President, but he won by a landslide; and in 1940 an even larger proportion took up the cudgels to defeat him, again without success. In municipal and some state elections the press appears to have almost no influence.

On the other hand, the press sometimes wields great power. It has doubtless been partly responsible for our high-tariff policy in the past, and for the general hostility to labor organization today. Most of the newspapers, in their hostility to the New Deal, hammered persistently on the theme that the government bureaus were inefficiently operated by wild-haired and largely communist professors—a completely false charge, yet many people believed it.

The press shows real power whenever its own interests are threatened, as when there is a threat to the advertising business. Although our better newspapers and magazines are careful regarding the kind of advertising they carry, they defeated the Tugwell Pure Food and Drug Bill in 1934, a bill designed to curb dishonest advertising, and they have always succeeded in preventing rigorous regulation or any legislation likely to reduce advertising seriously. In the fall of 1943, a bill was introduced in Congress to compel canners to grade their products and state the grade on the labels as a means of preventing evasion of price ceilings; but a combination of advertisers, newspapers, and the Canners' Association easily blocked it in the House of Representatives.

Some of the ways in which business interests seek to gain the support of the newspapers, and through them to mold public opinion, are shown clearly in the propaganda campaign of the National Electric Light Association against government ownership of public utilities. The utilities set up in the various states propaganda committees, called information committees, nearly all of them directed by widely known and experienced newspaper men. "Their efforts were spent in getting newspaper good will. In gaining this valuable asset a variety of methods were used. They aimed to create newspaper good will through advertising; inspired news articles written by the director but bearing the signatures of prominent persons were inserted; personal contacts with editors were made; newspaper men were entertained in various ways; news bulletins and clip sheets were prepared and widely distributed; and many speeches were made, either by members of the utilities industry or someone paid by the utilities to represent their interests."[10]

Some critics of our press are too indiscriminate in their criticism, too much inclined to indict the entire press, as if all newspapers were alike. Newspapers vary widely, from such liberal journals as *PM,* which is run at a loss by Marshall Field III and carries no advertising whatever, to strongly reactionary papers like the Chicago *Tribune.* Some conservative papers carry syndicated articles written by liberal journalists which may be contrary to the papers' general economic policy, thus offering readers a choice of conservative or liberal opinion.[11]

Business control of the radio

If the radio were free, business control of most of the big newspapers would not be quite so serious; but business interests also control most of the broadcasting. To some extent broadcasting time can be bought by anyone with the necessary cash, but few people have enough cash to buy time, for it is very expensive; hence only business interests can make a profit on such an expenditure. This means of course that the radio is predominantly a tool of the ruling business interests. There is some freedom of discussion over the air, and a few liberal or even fairly radical commentators broadcast regularly; but their broadcasts are censored by the broadcasting companies, and they are often obliged to omit some of their most pertinent comments. Both the National Broadcasting Company and the Columbia Broadcasting System recently refused to sell the Cooperative League, a consumers' cooperative, the time for a series of broadcasts on the ground that the programs would be devoted to "controversial issues." An aroused public opinion forced the two companies to back down; but it is not heartening to lovers of democracy to realize that these two giant concerns largely dictate the character of the broadcasts that go out to the people. It is even less cheering to learn that about a third of the stations in this country are owned and controlled by newspapers. Too much power controlling the channels to the public mind is concentrated in too few hands.

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[10] Temporary National Economic Committee, *Monograph No. 26,* p. 153.

[11] In the Kansas-Missouri area, for instance, the Kansas City *Star,* a conservative newspaper, carries daily syndicated articles of a distinctly radical character. Its reader can thus get both sides of most questions, if he really wants them.

The radio serves not only to puff dentrifices and laxatives, and vitamins, but to broadcast more or less well-concealed propaganda or economic questions. On the Ford symphony programs at one time, W. J. Cameron, a political reactionary rather closely associated with some American Fascists, was accustomed to talk for five minutes on the virtues of "American enterprise" and the vices of government regulation thereof. Similarly, during the General Motors symphony concerts, C. F. Kettering, a great scientist and vice-president of the company, gives a five-minute talk describing the marvelous achievements of American industry, the moral, gracefully camouflaged, being that private business is doing wonderful things. Some of our best musical programs are seasoned with diplomatically worded propaganda of this sort; and if we assume that the business leaders are not fools, we must conclude that they are getting their money's worth, that is, that the propaganda is effective.

The radio has indeed rendered two valuable services. Along with a vast amount of advertising which approaches the level of the patent-medicine show of a generation or two ago, it presents a small amount of really good entertainment, music and dramatics, some news—usually sponsored by a patent medicine, a face-saving soap, or a superior brand of coffee or cigarettes—and a modicum of reliable information in lectures. It has been an enlightening factor in political campaigns because it has enabled every party to appeal to the public. Before its development, the newspapers were the only medium through which candidates could appeal to the voters, aside from speeches at political meetings which could reach only a few of the voters; and the newspapers usually drummed for the most conservative party. But with the radio, a man like Franklin D. Roosevelt, opposed by most of the newspapers, could get his case before the voters in a broadcast. Even the Socialist party can usually buy time for a broadcast or two. The radio has done much to give real meaning and vitality to our political campaigns.

On most counts, however, the radio has been grossly mismanaged; in fact, it must be rated one of the worst failures of our democracy, in the sense that it falls farther short of its potentialities for good than almost anything else we have. Not only is it used to undermine public health through advertising all kinds of patent medicines, but, apparently on the theory that people should be kept as ignorant as possible on economic and political questions, its use is generally restricted to the discussion of "non-controversial" issues, except in political campaigns. Actually, business interests are able to present their views on even highly controversial questions; but the more liberal side of such questions is frequently ruled out as "controversial." Even if the radio were open to conservative and liberal views alike, the forces of conservatism, with their fat wallets, would of course have every advantage. Nothing is so greatly needed in this country as free discussion of controversial questions, such as the Scandinavians are accustomed to; but the radio cannot provide this. Think what the government could do with the radio! It could broadcast operas, symphony and semi-classical music, jazz, dramas, news, forums, comedies on various wave lengths at all hours of the day and evening—at a cost of perhaps a cent a day per capita! But producing interests will not let us have such entertainment—it would sell no toothpaste or liver pills.

Business and education

It has often been pointed out that business interests largely control our educational process, from the grades to the colleges and universities. Teachers in grade schools and high schools are accorded little freedom in the discussion of economic issues. Our colleges and universities are governed by boards of trustees, for the most part businessmen and lawyers; and in only a few institutions, perhaps one-tenth of them, are teachers accorded much freedom of expression, for only views acceptable to the governing business interests can safely be expressed. Mark Twain's remark is pertinent for many teachers: "It is by the grace of God that in our country we have those three unspeakably precious things: freedom of speech, freedom of conscience, and the prudence never to practice either of them." As for most of our students, we might say that they are not educated, they are only domesticated; they are trained to do and think the things that authority teaches them to do and think.

We can see a growing domination of higher education by business interests and business ideals in the changing emphasis within the colleges and universities. More and more of their funds are spent not for a liberal education in the problems of economic and political life, but for the training of men who can serve business—in schools of business, engineering, and journalism, for instance—or for the training for pecuniarily successful careers. In most universities the relative importance of the college of liberal arts shows a steady decline.

To many worthy people this situation seems altogether satisfactory; but to anyone who appreciates the difficulty of many of the economic problems we face, it seems rather ominous. Intelligent citizenship can be developed only through a process of free discussion of controversial issues, a critical appraisal of all points of view, a winnowing out of the grains of truth from the chaff of propaganda and misrepresentation; and no such process can be carried on in most of our schools. Education in the social sciences is largely a process of propagandizing in favor of the status quo, or better, a process of inoculating students against thinking about important questions. In this respect, we are far behind the Scandinavian countries, and this is one reason why the general level of economic and social intelligence is lower here than it is in those countries, and why we have been less successful in solving our economic problems.

A bold attempt to indocrinate students with a reverential attitude toward business and its leaders has been made recently by the National Association of Manufacturers. The N.A.M. published several dozen pamphlets panegyrizing the achievements of big business and eulogizing "freedom," "American enterprise," "free enterprise," and the like, which it has offered to supply free to all students in the social sciences in all colleges in the United States on request of the professors in charge. The pamphlets have been used to some extent in colleges and in adult education classes. With the same general purpose, the N.A.M. sponsors college oratorical contests on the Constitution, offering prizes up to $4000 for the best orations. If such contests called for a critical and unbiased study of the Constitution, they would do much good; but their purpose is rather to develop an unthinking and reverential attitude toward it, for the Constitution is regarded as the bulwark of the powers of the N.A.M. and its members. The American Bar Association has sponsored similar contests.

Through a law introduced by a reactionary Senator from Ohio during World War II, business interests were for a time able to prevent our soldiers from reading such liberal magazines such as *The Nation* and *The New Republic,* which dealt with "controversial" questions. Conservative publications like the *Saturday Evening Post,* however, were not construed to be controversial; only the liberal magazines were thus classified. This law also banned *Wilson,* an excellent moving picture depicting the political life of President Woodrow Wilson, particularly his fight for the League of Nations, in Army camps because it showed Republican party leaders in an unfavorable light. The law aroused such a storm of protest that the military was obliged to change its interpretation.

Business and the churches

Business leaders also have considerable influence in many churches. When the churches investigated the steel strike in 1919 and published a report favorable to the striking laborers, the report created a serious schism in a few of the churches and led some wealthy men to withdraw their financial support from those that had participated in the investigation. Since a few rich businessmen provide a considerable proportion of the financial support of most churches, preachers often find it necessary to avoid discussion of the problems of this earth, particularly labor problems; apparently our businessmen think it more important to prepare people for the next world than to make this one a more satisfactory place to live in.

Business and "red-baiting"

In recent years business overlords have found a new way of suppressing views to which they are opposed—through the underhand policy of branding them as "communistic." Business leaders have helped to build up a hysterical popular fear of communism and have been able to silence most of their critics by smearing them with the red paint of communism—not only the few actual communists, but socialists, progressives, New Dealers, and liberals of all shades. Some of our newspapers have indulged freely in this shady business, and the congressional Dies Committee has spent large sums of money ostensibly to ferret out "subversive movements," but actually to frighten liberals and suppress all views unacceptable to the ruling business oligarchy. Political scientists are agreed that this procedure, which as we shall presently see is taken from the bag of tricks of the Fascists in Italy and Germany, has done much to undermine democratic government in the United States. Self-appointed defenders of American capitalism have also inaugurated well-organized campaigns to make it appear that the faculties and students of many colleges and universities are largely communistic. In this way they have done much to purge the teaching ranks of liberals and prevent too much thinking by the students, at any rate on important economic questions.

Business and the courts

It is often contended that powerful business interests have a great advantage in the courts; that in a capitalist society, as Oliver Goldsmith suggested, "the laws govern the poor, and the rich govern the law"; and that business interests are usually able to secure the appointment of acceptably conservative judges, most of them former corporation lawyers who see eye-to-eye with men of means—at least this was a common charge before the administration of Franklin D. Roosevelt. Rich and poor are alike forbidden to steal, or beg, or "sleep under bridges"; and rich and poor are equally free under the law to contribute to political campaigns, to buy newspaper space or radio time, to form or manage corporations. Wealth, however, certainly has every advantage in the administration of the law. Before the law all men are equal, if they have equal financial resources and equally good lawyers; but the poor cannot afford good lawyers and expensive litigation. Contrary to a rather widely held idea, legal principles are not self-enforcing. It has often been said that you cannot convict a million dollars, and this comes rather too near to being the truth. Referring to the difficulty of punishing rich malefactors, Bryan once said that the American commandment was apparently: "Thou shalt not steal on a small scale"; instances proving that it is safer to steal a railroad than a dozen chickens can easily be cited. Many men go to the penitentiary for stealing chickens, but a few have gone to Congress for stealing a railroad or a corporation or a hundred thousand acres of land or a million dollars. It is not suggested that the rich are more wicked than the poor, but only that they are safer in being wicked, because they can defend themselves better.

Even constitutional guaranties sometimes mean little to the poorest class of people—to the sharecroppers of the South, for example, and the lowest class of laborers, particularly Negroes, and even more particularly if they happen to be radicals. Lynchings, mob beatings, the third degree carried to the point of murder, in some cases peonage or practical slavery—these are altogether too frequently the fate of the very poor in some parts of our country. Nor are the constitutional guaranties of the sanctity of private property always upheld.

Producer control of our lives

Looking at business control from a different angle, we see that in the capitalist world producer interests control the economy and the government to the general neglect of consumers, although consumption is assumed to be the final aim and purpose of all production. A mere handful of producers is often able to dictate government policies which are injurious to all consumers. The tariff is a good example of this. The producers who gain from a protective tariff include less than 10 per cent of the people, whereas *all* the people suffer as consumers; yet the tariff is firmly established in the American scheme of consumer exploitation. Interstate tariffs are likewise usually secured by a few producers, who are thereby able to charge all consumers higher prices for their products. When accurate labeling of commodities is asked for in Congress as a means of protecting 133,000,000 consumers from exploitation, a handful of canners, advertisers, and newspapers easily squelch the proposal.

Some important consumers' goods we may have only to the extent that the producing interests condescend to give them to us, and in the form and quality that they determine upon. Most people like music and entertainment. In concert halls, theatres, and movie houses we can choose our own entertainment, paying the full cost of it; but over the radio we get the kind and amount of entertainment that the various producing and advertising interests find it profitable to provide, at no direct cost, although of course consumers pay the bill indirectly, in the prices of the goods advertised. The entertainment of 130,000,000 people is merely a by-product of radio advertising.

Business control in time of war

Business control tightens in time of war, for various reasons. In the first place, the government needs various types of war goods promptly, and businessmen who can supply those goods find themselves in a very strong position. They can strike hard bargains with the government and so make handsome profits, and they can and do generally demand that the government put businessmen in most of the important positions created for prosecuting the war. Although it is rather widely believed that most of the war agencies that were created during the Second World War were headed by professors, the truth is that most of them were in charge of businessmen.

A second reason for the tightening of business control is that in their patriotic fervor the people do not watch the government as closely as usual, and do not understand some of the problems raised by the war, whereas powerful business interests are always on the job, always watching and working to strengthen their position, and, often in cordial cooperation with military leaders, are able to build up their power even more, and to eliminate some of the controlling and regulating measures established in peacetime. Democracy always suffers during both the war and the postwar period. Many business leaders have been assigned as "dollar-a-year" men to positions in which, as government agents, they are obliged to formulate policies that affect their own businesses in various ways; and there can be no doubt that they have sometimes sacrificed government interests to their own.

Limitations on business control

Even if we grant the truth of much that has been said about the domination of business in a capitalist economy, we need not concede that our political democracy is entirely a false front. It would be more genuine if there were greater economic democracy, and there are clear indications that it must move in this direction if it is to survive; but it has much reality, even in its present form. In spite of the asserted control of our press, radio, schools, and pulpit by business, the people do sometimes force through legislation in the interests of labor, farmers, and consumers that is opposed by the "ruling class"; and such legislation may be upheld by the Supreme Court, although that usually conservative body has as a rule been sympathetic with business. Some of the New Deal measures illustrate this. There has for many years been a general advance in legislation for the protection of labor, culminating in some of the New Deal labor laws; an increase in the amount of regulation of railroads, banks, and other kinds of business; a great increase in the proportion of taxes paid by the rich; and a rather steady increase in the number of government services offered to the public, in the financing of which the rich pay out of all proportion to the benefits they receive. Although business leaders have opposed almost all such policies, they have not been able to block them.

Need for a better balance of power

In most capitalist countries business leaders have too much power. A higher type of civilization is found in countries where the influence of the various classes is better balanced, as in New Zealand, Australia, and the Scandinavian countries. Even in increase in production of goods these countries have a better record than we do.

Business control and other forms of control

Even if business leaders have too much power in a capitalist society, we need not conclude that capitalism is therefore worse than other economic systems, or that it is as bad as some others. Certain political scientists believe that every economic society must have what is called a "ruling class." In feudalism, it was the feudal lords and nobles; in communism it is the party bureaucracy; in Fascism the party bureaucrats, the army, and the wealthy businessmen may share the power, but the masses of the people have no rights. Under socialism, theoretically, society should be more democratic than it is under capitalism, but it is not certain that a socialist system could be kept democratic, for reasons which will appear later.

In defense of capitalism

Vast productivity The most important virtue of capitalism is perhaps that it has been enormously productive. The era of capitalist expansion—roughly the past two or three hundred years—coinciding with the machine age, has been a period of amazing increase in wealth, as we have seen; and there can be little doubt that this vast increase, including the machines that produced the wealth, has been the fruit of the capitalist philosophy. The reliance on self-interest, on the profit motive, has brought powerful productive forces into operation.

In spite of its amazing production record in the past, capitalism is unable to reach the level of potential production, and there is some doubt whether it measures up to the standards set by the Fascist and communist states. The Fascist regimes of Germany and Italy stepped up production far above that of the earlier capitalist regimes simply by putting idle men and capital to work; but this production has been mainly concentrated on war materials.

A few years ago, most observers were skeptical about the productive efficiency of communism, in spite of the glowing reports of the Russian achievements; but Russia's amazing resistance to the German invasion has called for a drastic revision of these pessimistic judgments. It is now clear that the Soviet Union was building up Russian industry at an astonishing rate, for such magnificent war as that waged by the Russians would have been impossible without an efficient industry behind the army. In creating such an economy in the short space of about twenty years, the Soviet government has apparently set a production record beyond that of any capitalist nation; hence, on the score of production, in which capitalism has been thought supreme, communism may possibly prove superior. But we shall do well to reserve judgment on that point. Furthermore, even if communism proves more productive, most Americans would still prefer capitalism because in some respects it offers greater freedom.

Freedom. From a broad historical point of view, personal freedom and democracy, such as they are, appear to be in considerable measure the fruits of capitalism. Throughout most of the world's past history, and in nearly every country, the usual condition was government autocracy, with virtual slavery or serfdom for the masses. For a time there was a fine democracy in Athens, with a large measure of freedom for the citizens, but it was based on slavery. Moreover, most of the great political writers of Greece did not regard democracy very favorably; Aristotle was perhaps most sympathetic toward it, but he accepted it with reservation; and Plato's Republic was an autocratic state. At one time Rome had what is often called a democratic (or republican) form of government, but it offered no such recognition of individual rights as we in the United States have today. In the Middle Ages, in spite of the democratic implications of Christianity, autocratic domination by kings, nobles, or the church, and serfdom for the masses, was the rule. As late as 1789 the peasants of France were so cruelly exploited that they rose in revolution against the king and the nobility. Over the long stretch of five thousand years of human history, democracy, somewhat as we now know it, has prevailed for only a century or two, and that brief span coincides with the period of capitalist development.

Logic suggests that democracy and individual freedom are closely bound up with capitalism, at least in its earlier stages of development before economic control becomes too highly centralized. Capitalism calls for individual initiative; it involves the assumption that men, left free to work out their own destinies, will profit in proportion to their social contribution; it assumes competition, which can operate satisfactorily only when the competitors enter the field on something like even terms; and all this demands a measure of economic democracy as well as democratic political forms. Capitalism assumes that the right of private property is fairly secure; but this right cannot be very secure if the government is highly autocratic. Capitalism in this simple form demands a democratic form of government, with a minimum of government interference; it is therefore incompatible with political autocracy.

Our highly integrated, corporate capitalism of today does not fit this picture very well, to be sure. The economic area in which the rugged individualism of personal entrepreneurship is appropriate is shrinking steadily before the advance of highly integrated corporate business, in which individualism has little more place than it would have in a socialist economy. Businessmen themselves are asking for some of our most important forms of government intervention. Furthermore, the spread of industrial combinations, chambers of commerce, and trade associations indicates that business is best served not by rugged individualism but by organization. In our modern world of organization and super-organization the individual does not have a very significant place.

It is often argued that the individual freedom afforded by capitalism is of no great benefit to laborers, who are compelled to work for whatever they can get, driven by hunger as truly as the galley slaves were driven by the lash. How much better off, so the question is sometimes asked, are the common laborers who must live in slum tenements, picking up whatever jobs they can get, never certain how long their jobs will last or if they lose them that they can get others, with no reserve funds for sickness or emergencies, periodically unemployed, perhaps for weeks or months, while their families lack food—how much better off are they than slaves, who at any rate are not fretted by the fear of losing their jobs? How real is this vaunted freedom to the millions of unskilled laborers, or even to many of the higher grades of workers who at best have only a mean and precarious living and at worst, unemployed, have no recourse but the charity rolls?

The argument, applied to a capitalism that works reasonably well, that usually provides jobs for those who want to work, is not convincing. It is true that many laborers have to accept low wages if their labor is of the grade that is always overplentiful in the market; and unless organized, they cannot bargain much with employers as to conditions of employment. In the steel mills, in some coal mines, and in a few other industries, the condition of some of the laborers once had elements of slavery or peonage. Nevertheless, the notion that their condition is not preferable to that of slaves involves an underestimation of the terrible evils of slavery.

As applied to a capitalism such as we had between 1929 and 1939, in which as many as one-third of the laborers were unemployed and almost hopeless of finding jobs, the argument cannot be dismissed lightly. Between 1929 and 1939, there were an average of around 10,000,000 unemployed in the United States. Freedom has little meaning for the unemployed; even though they may be receiving unemployment benefits, men who are jobless and hopeless of finding work are generally willing to surrender their freedom for jobs and security. This is proved by the action of the unemployed in Italy and Germany at the time of the Fascist revolution. Although Fascism puts labor, along with most other classes, in a position scarcely distinguishable from slavery, many of the unemployed welcomed the Fascist regime and were probably happier under it, before the war, than they had been under capitalism. If our economic stagnation of 1929–1939 had persisted much longer, our unemployed millions would doubtless have turned to Fascism or to anything else that would give them jobs and economic security.

Whether freedom, which accompanied capitalism and has been lost in countries which discarded capitalism, is essentially good—even the greatest of goods, as some philosophers insist—is not primarily an economic question; yet it is so important that we must consider it briefly. To the present writer, liberty—freedom

—is not only good but essential to what we regard as civilized life. A good, all-wise dictator could do many things better than a democratic government, could provide better for the economic needs of his people, and perhaps even for their cultural advancement; but history proves that such dictators are rare. Even those who want to do well for the people soon find themselves obliged to resort to brutal and inquisitorial repression in order to hold their power, and most of them presently become more interested in extending their own power than in providing for the people's welfare. Dictators usually do not feed the people as well as democratic rulers, and they do not provide the freedom essential to intellectual and cultural advancement, the freedom which is about all that distinguishes men from beasts. This will be considered more fully in the chapters on communism and Fascism.

The freedom that we have achieved is not due entirely to the operation of the laws of laissez-faire capitalism. Even a capitalist system in its simple form, with reasonable economic equality, could not provide all the freedom that we enjoy. Since it would operate without any government intervention, it would to some extent be governed by the law of the tooth and fang, and the weak would suffer at the hands of the strong. Consequently during the nineteenth and twentieth centuries the government has intervened more and more to protect the weak and unfortunate, has passed laws for the protection of women, children, workers, the sick, aged, unemployed, and indigent. Although in so doing it has enlarged the sum total of human freedom, such legislation is to some extent a departure from the principles of laissez-faire capitalism.

Conclusion

Thus, in conclusion, we must concede that, historically, capitalism has brought abundance of goods and more freedom than was ever known before. These are tremendous contributions. In recent years, however, it appears to have lost its capacity to increase production, and some capitalist countries have lost their freedom in a shift to communism or Fascism. Capitalism appears to have entered a decline. Before discussing this, however, we must consider another important characteristic of capitalism—perhaps it might be called another vice—economic imperialism.

QUESTIONS

1. Describe the integration of business interests. In what respects are business organizations more effective than farm, labor, or most other organizations?
2. Franklin D. Roosevelt was elected President four times in spite of the opposition of almost all big and small business. Does this suggest that there is nothing to the notion that business controls politics?
3. In what ways are big newspapers tied in with business interests?
4. Some large newspapers carried stories on medical reports to the effect that few people need vitamin tablets. Do not vitamin producers advertise?
5. Why cannot the United States Bureau of Standards make available to the people the information it has about various kinds of goods?
6. Why is the radio almost entirely an instrument of business interests? Is radio advertising worse than newspaper advertising?
7. What economic propaganda do you hear over the radio? Might a sponsor properly insist that you listen to such propaganda, since you enjoy a free concert? Is the concert really "free?" Who finally pays for all the radio advertising?
8. How many men do you personally know who have contributed to the campaign expenses of either of our political parties? Who does furnish the money?
9. Do you know many communist students? Why do some newspapers and politicians emphasize communism as a serious danger to the nation?
10. Give illustrations of producer control of our economy and government.
11. Why does producer control of our government increase in time of war?
12. Even if communism proves to be more productive than capitalism, will not most Americans prefer capitalism? Why or why not?

Chapter 38.

An Appraisal of Capitalism: Imperialism

One of the vices commonly attributed to capitalism is imperialism. Like capitalism itself, imperialism is a rather complicated bundle of concepts, it changes from one stage of its development to another, and it varies somewhat from one country to another; and for all these and other reasons it is impossible to define precisely. It usually involves the exploitation of one people, race, or nation by another. In what is called *political imperialism,* the exploitation is carried on for the sake of national aggrandizement, often through conquest, enslavement, rape, pillage, wholesale murder, and forced tribute; whereas in what is called *economic imperialism* the exploitation is assumed to be carried on for economic gain, through trade and investment, but usually also through conquest, with more or less enslavement, loot, and pillage. The Roman Empire and that of Charlemagne are said to represent political imperialism; the British Empire, economic imperialism. This distinction is so vague, however, as to be scarcely worth drawing. In looting conquered provinces and in exacting tribute, Rome sought economic gain quite as much as mere national aggrandizement; and Britain's expansion, particularly in its early phases, has been accompanied by more or less loot, pillage, and even practical enslavement of subject peoples. There has been a general tendency toward humanization of the process of conquest from Roman times to the present. In this chapter we are concerned with economic imperialism, for it is the type that is related to capitalism.

Economic imperialism may be defined as *a policy, usually dictated by wealthy capitalists, which seeks economic and political control of outlying territory, particularly that of the so-called backward peoples, as a market for goods, as a place to invest capital, or as a source of raw materials.* The relative importance of these three objectives varies with circumstances, particularly with the stage of capitalism represented by the imperialist nations. The demand for a market for goods usually appeared earlier than the demand for a capital market or for raw materials.

History of economic imperialism

Modern economic imperialism may be said to have appeared first in Spain, after the discovery of America. Spain tried to maintain monopoly control of the trade with her American colonies, and of the production of the precious metals there, using, however, the Roman policy of loot, pillage, and tribute instead of constructive investment and economic development. Spain herself was not strong enough industrially or financially to supply the products or the investments needed to build up the colonies, even if she had followed the ideal of economic development. The result was a gradual weakening of her empire, with the Dutch, French, and English taking over more and more of the trade with the New World and building empires for themselves.

Great Britain has the greatest empire known to history, and some of the episodes in its development are familiar to every American schoolboy, for it was her selfish imperialist policy that brought on the Revolutionary War. Thus she was trying to restrict her American colonies to agriculture, in order to keep them a good market for her manufactured goods, she was investing her surplus funds there, and she wanted raw materials, for instance lumber, for her industries and her Navy.

In India her policy was similar but more oppressive, as it was also in Ireland. British capitalists built railroads and a few other industries in India, but their general policy there was to prevent the development of any industries that might compete with those of England; indeed, soon after the occupation of India the British instituted various measures to destroy her extensive and world-famous cottage industries. Indian industries were held down for more than a century; and when this policy was changed, early in the twentieth century, to a policy encouraging industrial development, India's new industries were largely controlled by British capitalists. The Second World War gave the British some reason to regret their earlier policy, for better-developed industries, particularly steel and other metals, would have helped greatly in fighting Japan. And if Great Britain had been less selfish and oppressive in her Indian policy, she could have relied more on the loyalty of the natives; the well-earned disloyalty of the people of Burma was an important reason for the success of the Japanese invasion of that province.

Inner imperialism

The United States, with vast areas of free land available for development, with the agricultural West and Middle West serving as a market for the manufactured goods of the East as well as an investment field for the savings of eastern capitalists, and with relative abundance of natural resources, had little occasion for a policy of foreign imperialism prior to the 'nineties. Our eastern capitalists could enjoy most of the benefits of economic imperialism right at home: markets for goods and capital, and raw materials; and this imperial domain was pretty largely under their own political control most of the time, for wealthy capitalists largely controlled the policies and candidates of the dominating political party after the Civil War. As a result, the United States developed what Lewis Corey calls an *inner imperialism.* Wealthy capitalists of the East had a market for their goods in the expanding West, a market which they could to some extent monopolize under high tariff duties. They could also invest their savings there, lending to the pioneer farmers on mortgages, building railways, factories, and public utilities, and buying up and exploiting natural resources. They utilized the South in similar fashion. This situation has persisted from colonial days down to the present.

The economic forces behind imperialist expansion demand some analysis, and the three elements—markets, investments, and raw materials—require separate treatment.

Imperialism and the market for goods

Big manufacturers seek foreign markets for their goods for somewhat the same reason that they seek enlarged domestic markets. The productivity of modern industry is so great that producers are often unable to operate at full capacity because they cannot find markets at prices which will yield what they consider a satisfactory return. Here the problem of monopoly enters. Most such industries are more or less monopolized; therefore, in order to keep their prices up these producers must either restrict production or find foreign markets, or both; and they wage an aggressive search for foreign markets in order to maintain at lease the output which will yield them maximum profits. Exporting manufacturers obviously prefer to have political control over the peoples to whom they export, for it may enable them to prevent these peoples from imposing high tariffs against them; it might even be possible to persuade them to impose such tariffs against their competitors, thus securing for themselves at least a partial monopoly of the trade.

Imperialism and the market for capital

The need for foreign fields in which to invest surplus savings arises, particularly in monopoly capitalism, because the big industries make large profits which they can invest at home only at a declining rate of return. There is a scarcity of capital in most of the undeveloped territories, and although the risks are often heavy, the profits may be high. Once such investments are made, they tend to increase. Even if there are no net or pure profits from such ventures, the mechanics of compound interest, plus further investments from the home country, builds up a larger and larger interest in the undeveloped territory. It is thus that Great Britain, and to a lesser extent France, Germany, Belgium, and Holland, piled up their vast foreign investments. For Great Britain these amounted to some 20 billions in 1900; for France, 10 billions; and for Germany, 5 billions. Much of this was dissipated in the First World War—almost all of Germany's holdings.

Our total investments abroad in 1940, represented by foreign bonds and direct investments, was approximately $10,600,000,000, of which about $7,000,000,000 was in direct investments such as public utilities and transportation, manufacturing, petroleum, mining and smelting, agriculture, and various other industries. The total annual return on our direct investments was about $450,000,000, a fairly high rate of return. These direct investments were distributed abroad as follows, only the most important areas being included:

Africa	$ 131,073,000
Asia	421,945,000
Australia	97,670,000
Canada	2,098,941,000
Cuba	559,797,000
Europe	1,420,365,000
Netherlands Indies	71,275,000
New Zealand	22,562,000
Philippine Islands	90,695,000
South America	
Argentina	387,945,000
Brazil	240,109,000
Chile	413,983,000
Colombia	111,616,000
Peru	81,597,000
Venezuela	262,376,000

Political control is even more important for investments than for trade. Many of the "backward peoples" have not the capitalist regard for the sanctity of contracts; hence investments without political control are hazardous. In many cases, this control, though not open or absolute, may be made fairly effective through political manipulation and threats of military coercion. Our control over Mexico and the Central American republics is of this nature. Until recently, American capitalist interests had heavy investments in Mexico's railroads, oil lands, refineries, plantations, and mines; and while Mexico is nominally an independent nation, almost all her Presidents, since American investments became important, have had to be acceptable to certain of our powerful capitalist groups. When a President was unwilling to meet their demands, they subsidized a revolution against him; in some cases they were able to bribe him. Thus one American oil magnate "lent" a President of Mexico $5,000,000, apparently in consideration of the recognition of oil rights; and several other Mexican Presidents have made large fortunes while in office. Some have been obliged to walk a political tightrope, for Lord Cowdray's British Mexican Eagle Oil Company also had extensive oil interests in Mexico; and for some years British and American oil companies fought bitterly for oil concessions, with the State Department at Washington backing our companies, as it has usually done in similar imperialist ventures elsewhere in the world. This is the so-called "dollar diplomacy" which liberals have often complained about.

American capitalist interests have heavy investments elsewhere, which they have tried to protect by somewhat the same methods as those used in Mexico. The United Fruit Company has heavy financial interests in Central American plantations, ships, and docks. Our investments in Cuba, many of them held by New York banks, are mostly in the sugar industry, but partly in real estate, railroads, government bonds, public utilities, and other valuable property. Although nominally free, actually Cuba is under the rather complete domination of the New York banks, which are able to dictate even the choice of Presidents.

At the present time, our investments in the Latin-American countries amount to more than 6 billion dollars. Partly to protect these investments, and partly to protect the Panama Canal in the interests of national security, the United

States has assumed a virtual protectorate over the Caribbean area and has exerted varying amounts of control over the countries of South America. In an effort to preserve law and order, particularly in Central America and the Caribbean, lest a foreign country find a pretext for intervention, we have suppressed such "bandits" as were not amenable to our control. We have encouraged some of these countries to pay off their debts to other countries with American loans; have practically forced loans upon several of them and have then taken over the customs duties to insure their payment; and on occasion we have established military governments in Cuba, Haiti, Santo Domingo, and Nicaragua.

Imperialism and raw materials

Investments in the natural resources of undeveloped countries may be made not only for the profits to be made directly from their exploitation, but in order to secure needed raw materials. One of the reasons for England's colonization of America was her desire to get the gold and raw materials that the colonies were expected to provide. American steel interests own iron mines in Cuba, Brazil, Chile, and the Philippines, and our copper interests own extensive copper reserves in Chile; British steel interests have mines in Africa, Spain, and Canada; a British combination controls much of the world's tin, in Malaya. Throughout the world, users of raw materials have reached out for control of those materials, generally with strong government support. The oil industry offers many illustrations in the struggle for oil reserves, with British and American interests, backed by their respective governments, fighting for oil lands in Iran, Turkey, Colombia, Venezuela, Mexico, and elsewhere.[1] Government support for imperialist business interests has been particularly aggressive in the case of oil because of the vital necessity of adequate reserves for naval and air use.

The profits of imperialism

Most of the colonies that imperialist nations have intrigued for and fought for are probably not worth having, for most of them are not important as producers of raw materials. According to one estimate, colonial areas produce less than 1 per cent of the world output of lead ore, coal, asbestos, potash, jute, flax, linseed, and manilla hemp. Most of the oil and other basic commodities, except rubber and tin, are found in non-colonial areas.

Control over the Philippines has involved a heavy net loss to the United States, aside from the costs of the Spanish-American War; and the European imperialist countries would probably be better off without most of their colonies. Great Britain has profited greatly from India and a few other dependencies, and Holland has made large profits from her possessions in the East Indies; but most colonies are carried at a loss. An imperialist nation usually has to wage an expensive war to obtain colonies, and it must maintain control over them and keep off other greedy nations by means of costly military organization. Our military expenses climbed rapidly after we acquired the Philippines, not merely because we had these and a few other islands to administer and defend, but because with them we caught the imperialist spirit and felt that we should have a larger Army and Navy to correspond with our new greatness as a nation. Our feeling of greatness may be worth the money, but we should recognize that it costs money.

The imperialism of such nations as England, Holland, and France may well have been of considerable benefit to other countries, who have been able to buy colonial products on the same terms as the countries who control the colonies. The rubber and tin of Malaya and the East Indies, for example, were developed by British, Dutch, and French capital but have been available to buyers from other countries without discrimination, although at high prices set by the rubber and tin monopolies. Other countries have been at a disadvantage in one respect, however, for in some cases the imperialist powers have imposed discriminatory tariffs against foreign products imported into the colonies, and as a result the foreign countries have found it difficult to get the exchange with which to buy colonial products. This disadvantage has not been serious in general, and it is doubtless balanced by the fact that the other nations have none of the expense of maintaining colonial possessions. The prosperity and high culture of the non-imperialist Scandinavian countries suggest that imperialism is not essential to prosperity or cultural development.

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[1] On this question, see Ludwell Denny, *We Fight for Oil.*

While imperialism has not been profitable to the people of the imperialist nation as a whole, it has been highly so to a few wealthy capitalists. Much of the profit of the trade with India goes to a relatively few British capitalists, whereas the expense of maintaining the British Navy, needed partly because of these imperial possessions, is borne by the taxpayers as a whole. The United States has carried on an exchange of diplomatic notes with Mexico for years and has invaded that country a number of times, largely in support of oil interests whose total investment was far less than the cost of a war would have been. The increase of wealth in the hands of capitalists may be indirectly beneficial to the people as a whole, but it usually does not justify heavy military expenditures for the maintenance of imperial possessions.

Imperialism and the colonial peoples

In ordinary business transactions, such as foreign trade or investments, both parties presumably gain; and this may be true in imperialism, particularly if the imperialist nation does not have political control either openly or through subterfuge. British investments in the United States were generally beneficial to the people of the United States, for they enabled us to build railroads and other productive enterprises earlier than we could have with our own savings. This was true also in India; but, as we have seen, Great Britain impeded the development of some of India's other industries. Even when the imperialist nation has political control, it may treat the colonial peoples with reasonable consideration; the United States, for example, has done much good in the Philippines in promoting education, sanitation, and general administrative honesty and efficiency. Moreover, many peoples were grossly abused by their own rulers and by each other before the imperialists came. India, for instance, was not a very happy land before the British came. Some of the powerful Indian princes exploited their subjects without mercy; and there were such institutions as suttee and caste, with millions of miserable untouchables. Slavery also was common in some countries before the imperialist powers employed it for their own profit. An important reason why native leaders have objected to domination by imperialist powers has frequently been that they preferred to exploit the people themselves rather than have foreigners do it.[2]

In some cases, imperialist control of backward peoples has certainly raised the standard of living. This has been true of some of the Dutch East Indies, and of many British and American colonies and dependencies. The Malayan tin mines and rubber plantations could not have been developed without British capital, and they have undoubtedly added to the wealth and income of the natives. Whether they added to their happiness is another question. Working conditions there are wretchedly bad by western standards, and it is by no means certain that most of the natives would rather work in these mines and on these plantations, even at higher wages, than live the wild, simple life they had before. Capitalism has a way forcing men into its characteristic lockstep, regardless of their desires. Increases in income, furthermore, are often largely lost through increases in the population. Where the Malthusian principle holds full sway, standards of living cannot be raised very much.

The inner imperialism of the United States, like foreign imperialism, has been of limited benefit to the "colonial areas" of this country. The profits of this imperialism—investments in farm mortgages, bonds, public utilities, mining enterprises, and factories—have raised the total wealth of the country and the standards of living of our people as a whole; but these colonial areas have not shared equally with the great financial centers. Urban capitalists have absorbed a larger and larger percentage of the country's wealth and income; billions have piled up in New York, Boston, Philadelphia, Chicago, and other large cities, while many farming communities have been losing wealth for at least twenty years before the war. Little of the benefit of this inner imperialism accrues to the share-croppers of the South, the wheat growers of the Middle West, or the miners, lumberjacks, and fruit pickers of the West. Some of them have automobiles and other luxuries that they never had before, but the many who do not are in relatively worse condition than before urban capitalism enveloped them in its tentacles; moreover, most of them have lost in security. Great mining corporations may declare millions in dividends, but the miners still live in their long rows of cheap, standardized shacks, and the mining districts where the wealth is produced are uniformly ugly and poverty-stricken. In working nearly all our forest and mineral resources, human resources have been exploited almost as relentlessly as the natural resources. There may well be a question whether, in the long run, exhaustible natural resources are of any benefit to the states in which they are located. Most of the resources and practically all the profits from them flow out of the community to areas of greater wealth, particularly the cities; and about all that is left is the barrenness of complete spoliation, and perhaps a few human derelicts eking out a poor living and hoping for better times. This is the general picture of the cutover timber lands of the Great Lakes and the South, of abandoned oil fields and mining districts, and of eroded farm lands everywhere.

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[2] See Parker Moon, *Imperialism and World Politics.*

Evils of imperialism

The dry rot of imperialist administration. One of the evils of imperialism is the dry rot that frequently appears in the colonial administration. This was brought glaringly to light in the Japanese invasion of Burma and Malaya, the success of which was due to the fact that British colonial administrators, mostly lazy, incompetent, snobbish, and indifferent to the welfare of the people, had never earned the loyalty of the Indian people and had made no effective plans for defense. This has been a common vice of colonical administration.[3]

Brutality of imperialist exploitation. Strong nations have abused weaker peoples brutally in various ways. For more than a century Africa was a slave hunting ground for some of the nations of Europe, and for the United States. Slave traders rounded up millions of blacks, drove them to the coast chained together like oxen, often as many as four-fifths of them dying on the way, crammed them into the holds of sailing vessels so thickly that they had to lie on their sides throughout a trip which lasted five weeks or more, and sold them at a high profit to plantation owners in various parts of the world. Only a generation or so ago, in his ruthless quest for the ivory and rubber of the Congo, the Belgian king, "Leopold the Unloved," burned, flogged, mutilated, tortured, and shot the natives who failed to bring their assessed amount of booty. According to one estimate, he killed 10 million Negroes in piling up one of the greatest fortunes in Europe.[4]

Even in recent years the Belgian government has employed slavery in the Congo to build railroads, exploit mineral resources, and grow certain crops, particularly coffee. The Italian governor of Libya is said to have killed half the population of that North African colony within a few years, apparently in a deliberate effort to make room for Italian colonists.[5] The Dutch East India Company employed a regular system of kidnaping slaves for labor on its plantations in the Dutch East Indies; for about a century the Dutch administration of these islands was a record of "the most extraordinary relations of treachery, bribery, massacre, and meanness."[6] Only a few years ago virtual slavery was still in force on the tobacco plantations of Sumatra.[7] Not many years ago, investigators found similar conditions on the rubber plantations of Peru, with flogging and murder common. The Spaniards killed many of the natives in South and Central America, and reduced many of the rest to slavery. The white conquerors of the United States killed many of the native Indians; the survivors were crowded onto reservations of worthless land that the white men did not want, where for many years they were subjected to many varieties of exploitation. Our record in dealing with the Indians is one of broken treaties, of ruthless land seizures, and in some cases extermination.

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[3] See Leland Stowe, *They Shall Not Sleep*, particularly chap. 6.

[4] See Ludwig Bauer, *Leopold the Unloved*.

[5] See Knud Holmboe, *Desert Encounter*.

[6] Jawaharlal Nehru, *Glimpses of World History*, p. 471.

[7] See accounts by Ladislas Szekely in *Harper's Magazine*, October-December, 1936.

Although Great Britain has been a leader in many humane movements, her record as an imperialist power is a sordid story. When, through bribery and forgery, Clive gained control of his first chunk of India, he seized the 2,500,000 rupees in the Bengal treasury and other valuable property for himself and his associates in the East India Company. To some extent as a result of his greedy exactions, Bengal suffered a terrible famine in 1770, in which a third of the population died; yet Clive and his company continued to collect their full revenues from the starving population. He was censured by Parliament for his various exactions, but there is a fine statue of him in London. When Warren Hastings became governor general, he continued this policy of conscienceless exploitation, along with such trade as was thought advantageous to the Company.

Even in recent years Great Britain has oppressed some of her subject peoples with little conscience. She has reduced some of the African natives to something much like slavery, her method being to levy taxes on them and, when they could not pay, to force them to work out the taxes. She recruited native labor for the Rand gold mines by some such process as this, and her treatment of the miners was for a long time little short of barbarous and is today far from humane.[8]

Britain has behaved no worse than other imperialist countries; indeed, her record is somewhat more humane than that of France, Belgium, Holland, Italy, Germany, or Japan, or perhaps of any country but the United States; yet in crushing the Indian rebellion of 1857 the British, according to Nehru, "spread terror everywhere. Vast numbers were shot down in cold blood; large numbers were shot to pieces from the mouth of cannon; thousands were hanged from the wayside trees. An English general, Neill, who marched from Allahabad to Cawnpore, is said to have hanged people all along the way, till hardly a tree remained by the roadside which had not been converted into a gibbet."[9] As late as 1919, when a peaceful crowd had assembled at Amritsar, India, to protest against certain government measures, the British general, Dyer, opened fire on them, killing over 500 and wounding several thousand, for which meritorious service he was retired on a full pension, paid from the Indian treasury. Even later than this, the French Army tried to terrorize the Syrians by shooting innocent people and burning their villages; they destroyed a great part of the famous ancient city of Damascus. In 1915 the United States invaded Haiti and established a dominion there after killing more than two thousand Haitians—undoubtedly "bandits."

Few countries have suffered from European imperialism as much as China. Indeed she would long ago have been dismembered and parceled out among the greedy European powers had they been able to agree on a division. Most discreditable of all was the British and French burning of the Imperial Summer Palace with its priceless treasures of Chinese art, and the forcing of the free importation of opium upon China. England fought the Opium War with China to secure this concession for British opium dealers.

Imperialism and Fascism

The civilized world has been rightly shocked at the barbarous crimes of the Nazis, both at home and in occupied countries; but the practices of the Nazis followed patterns set by other nations in earlier periods. Hitler's strategy of dividing and conquering has been followed by other imperialists for hundreds of years; for example, the British government has usually tried to increase the prevailing hostility and suspicion between the Moslems and Hindus in India, and has supported the feudal princes against the people's demand for greater democracy. The Nazis looted conquered lands; so did other imperialist countries. The Nazis killed any patriots who tried to defend their homes; so did other countries. The Nazis killed innocent people to terrorize the inhabitants of conquered lands; so did the British and French and Dutch, and for the same purpose. The Nazis reduced thousands to virtual slavery; but this has not been uncommon in imperialist conquests. The Nazis imposed heavy fines on cities, communities, and nations; but other nations set a precedent for such exactions. When, during the British occupation of Egypt, a British functionary was killed by the Egyptians, the British government made no investigation, but demanded an apology, imposed an indemnity of £500,000, prohibited all political demonstrations, and exacted other onerous concessions from the Egyptians. Moreover, Englishmen in Egypt were not subject to the laws of Egypt or to most of the taxes levied on the natives.

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[8] See Adèle Lezard, *The Great Gold Reef*.

[9] Jawaharlal Nehru, *Glimpses of World History*, p. 415.

The imperialism of Germany and Japan thus followed precedents set by other great powers, but it was absolutely worse, and it seemed immeasurably worse because it occurred later in history, when we had become accustomed to more humane conduct. It also seemed more atrocious to us because the Germans were abusing white, so-called civilized people, whereas the earlier imperialist powers usually maltreated the backward races, who presumably did not suffer so much!

Lack of morality in international affairs

The purpose of this discussion is not to justify the barbarities of the Nazis and the Japs, but to show that such barbarities have been common in human history, and that only a repudiation of imperialism by all great powers can purge the records. Up to the present time, nations have developed no effective codes of moral conduct like those that govern the relationships of individuals. Our State Department and the Foreign Offices of other great powers are accustomed to act with little consideration for the principles of right, justice, and humanity. Without qualms, they not infrequently follow policies which mean great suffering for millions of innocent people. Only selfish "national interest" is considered. Nehru has expressed this well:

> With the growth of nationalism, the idea of "my country right or wrong" developed, and nations gloried in doing things which, in the case of individuals, were considered bad and immoral. Thus a strange contrast grew between the morality of individuals and that of nations. There was a vast difference between the two, and the very vices of individuals became the virtues of nations. Selfishness, greed, arrogance, vulgarity were considered utterly bad and intolerable in the case of individual men and women. But in the case of large groups, of nations, they are praised and encouraged under the noble cloak of patriotism and love of country. Even murder and killing become praiseworthy if large groups of nations undertake it against one another. A recent author has told us, and he is perfectly right, that "civilization has become a device for delegating the vices of individuals to larger and larger communities."[10]

But if people are generally fair, kind, and decent, why, in democratic nations, will they uphold a national policy which violates all codes of fairness, kindness, and decency? The answer is not very difficult. In the first place, the people know little about imperialist policies and abuses; the outrages perpetrated on the African Negroes were not covered by newspaper correspondents. In the second place, imperialist interests often defend their aggression as an effort to give inferior peoples the benefit of the government and culture of the superior (more powerful) nation, somewhat as the defenders of slavery often argued that the inferior slaves were better off as slaves than they would be as free men trying to solve their own problems. Some imperialist interests have used missionaries rather extensively in their expansionist programs, to Christianize the backward, pagan peoples, while the businessmen gave them a stabler and of course much better government and higher culture—and incidentally picked their pockets. The Spaniards and the Pilgrim Fathers came to America partly to give the heathen Indians the blessings of Christianity; and when it was found necessary to exterminate many of the Indians in the process of Christianization, this was thought justified by the nobility of the general purpose of the enterprise, particularly since the land taken from the Indians was good for farming. Of course many missionaries were different—they worked unselfishly for the betterment of the backward peoples.

Imperialism and wars

The imperialist ambitions of powerful capitalist interests, backed generally by their respective governments, have been the cause of so many wars that men often speak of "imperialist wars" as if there were no other kind. Although it is impossible to say exactly what "causes" so complicated and many-sided a thing as war, one of the important causes of the Revolutionary War, as we have seen, was England's greedy imperialism. The War of 1812 does not quite fit the traditional imperialist pattern, as far as the United States was concerned; for, according to Charles and Mary Beard, it was generally favored by the men of the agricultural frontier who wanted new lands in Canada and Mexico, and opposed by the mercantile interests of the coast cities. The Mexican War was likewise advocated by farmers who wanted more land, but the New England capitalists also supported it because of the profits to be made in the Paçific, particularly in California (then a part of Mexico). The Beards suggest that holders of Texas bonds, some of whom were in Congress, constituted a powerful influence for this war. They had bought up the bonds for next to nothing, and shrewdly foresaw that if Texas were wrested from Mexico, the United States government would assume the payment of the bonds at face value. Here was capitalist imperialism in a rather unusual form.[11]

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[10] *Ibid.*, p. 611. By permission of The John Dav Company, Inc., publishers.

It may seem fantastic to think of the Civil War as an imperialist war, yet the Beards hold that to some extent it was that; according to them, the most important issue was not slavery or states' rights, but the domination of the country by the tariff-protected capitalists of the North. Although many historians do not agree with this interpretation, the tariff and the threatened domination of the government by northern capitalists were undoubtedly important issues.[12] At any rate, "Viewed in the large, the supreme outcome of the civil strife was the destruction of the planting aristocracy which, with the aid of northern farmers and mechanics, had practically ruled the United States for a generation. A corollary to that result was the undisputed triumph of a new combination of power: northern capitalists and free farmers who emerged from the conflict richer and more numerous than ever."[13] Whatever the forces that led to the war, it was scarcely over before the tariff was raised, thus enabling the northern manufacturers to exploit the South, along with all consumers, through higher prices for manufactured products.

There were also indications of an American interest in foreign imperialism at least as early as the Civil War, for during that war American naval officers bombarded a Japanese seaport in an effort to compel Japan to open her ports to our trade, and the United States joined Great Britain in forcing her to sign a trade treaty. This did not lead to war, because Japan was not strong enough to fight. After the Civil War, the high-tariff policy of the dominant Republican party gave American manufacturers a monopoly of a rapidly expanding home market, and there was little interest in foreign imperialism until the time of the Spanish-American War.

Historians differ in their interpretation of the Spanish-American War, but without doubt it was in some measure an imperialist war on our part, for around 1898 our government embarked on a definitely imperialist foreign policy. It may be significant that this policy took definite shape about the time of the disappearance of free public lands and the formation of great monopolistic combinations in this country. From the Spanish-American War we gained three important areas for capitalist development—Cuba, Puerto Rico, and the Philippine Islands. Even before the conclusion of the war, the Hawaiian Islands, soon to become a rich producer of sugar and pineapples, had been annexed. Within a few years the United States joined the European powers in parceling out trade privileges in China. The United States objected to the dismemberment of China which had been proposed by European powers, and instead insisted on the "open door," which meant equal rights to trade in China, for all except the Chinese; our treatment of her after the Boxer uprising was fairly decent and humane, compared with the selfish policies of the European powers. Even so, the struggle of those powers and of Japan and the United States for rights and privileges in China threatened to bring us into war; but when Woodrow Wilson became President in 1912, he refused to back some of the more ambitious schemes of American capitalists, and other nations therefore assumed the major role in exploiting China.

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[11] Charles and Mary Beard, *The Rise of American Civilization*, vol. i, chap. 13.

[12] See Burton J. Hendrick, *Statesmen of the Lost Cause*, p. 55.

[13] Charles and Mary Beard, *The Rise of American Civilization*, vol. ii, p. 99.

About this time foreign imperialism revealed some of its ugliest aspects, for England was carrying on a merciless war against the Boers. At the beginning of it Mark Twain wrote in indignation: "Without a doubt the first shot in the war is being fired today in South Africa *at this moment.* Some man had to be the first to fall; he has fallen. Whose heart is broken by this murder? For, be he Boer or be he Briton, it is murder, and England committed it by the hand of Chamberlain and the Cabinet, the lackeys of Cecil Rhodes and his Forty Thieves, the South Africa Company." Leopold of Belgium was mutilating and massacring the Negroes in the Congo, and the United States was shooting Filipino patriots in the process of conquering the Philippines. In his "Greeting from the Nineteenth to the Twentieth Century," written on New Year's Eve, 1900, Mark Twain sketched the general picture clearly: "I bring you the stately nation named Christendom, returning, bedraggled, besmirched, and dishonored, from private raids in Kiao-Chou, Manchuria, South Africa, and the Philippines, with her soul full of meanness, her pocket full of boodle, and her mouth full of pious hypocrisies. Give her soap and a towel, but hide the looking glass."[14]

American imperialism spread irresistibly, however, in the Gulf of Mexico, the Caribbean Sea, and the Latin-American countries, with undeclared wars which were usually referred to as campaigns to preserve order or to suppress "bandits." In 1903 President Theodore Roosevelt compelled Germany to retire from Venezuela; in the same year he instigated and subsidized Panama's revolution against Columbia, and as soon as that war was over, he recognized the independence of Panama and from her bought the land for the Panama Canal. In 1905 Roosevelt took over the customshouse of Santo Domingo, and in 1906 he announced our control over Cuba under the Platt amendment, although the United States had promised Cuba her freedom. In 1908 he served warning on Nicaragua that there must be no fighting which would injure American interests, and a little later our Marines, without congressional sanction, started a war there to suppress banditry and to secure a strip of land for the Nicaraguan canal and for naval bases. In 1914, our Army invaded Mexico, and in 1915 our Marines invaded and established control in Haiti, with the loss of only 2000 native lives; the next year the United States Navy took possession of Santo Domingo; in 1917 we purchased the Virgin Islands from Denmark, and our Navy went down to Guatemala to restore order there. These events indicate roughly the outline of what is often called the "good neighbor policy" of the United States toward her southern neighbors, which for some reason those neighbors have viewed with more apprehension than gratitude.

This policy has not represented economic imperialism exclusively, for considerations of national self-defense have dictated the acquisition or control of some of these lands. The Panama Canal was needed to enable our fleet to get from one coast to the other quickly, and we would of course be endangered by foreign naval bases in these regions. It was such considerations, to some extent, that led our government to pursue its imperialist policy with such vigor, but to some extent our motive has also been a desire for economic opportunities.

The First World War was imperialist on a grand scale. Germany wanted to expand her dominion eastward along the Danube to the Black Sea and the Bosporus; France sought to regain the rich mineral deposits of Alsace and Lorraine; Great Britain hoped to retain her control of the seas and to gain additional colonies; Russia coveted particularly Constantinople and the waterway from the Black to the Aegean Sea, and such other valuable real estate as she might be able to pick up; Austria-Hungary hoped to absorb Serbia, and additional territory in the Balkans; Italy wanted to enlarge her empire by adding the territory around the Adriatic Sea and other colonies elsewhere. None of the participants wanted war; but their territorial ambitions, secret treaties, and vast military establishments provided the munitions dump which needed only the lighted match to bring on the explosion.

Nehru summarizes the First World War as follows:

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[14] See Albert Bigelow Paine, *Mark Twain, a Biography,* vol. iii, pp. 1095, 1127.

> I have tried to examine with you some of the causes of this war: how the greed of capitalistic industrial countries, the rivalries of imperialist Powers, clashed, and made conflict inevitable. How the leaders of industry in each of these countries wanted more and more opportunities and areas to exploit; how financiers wanted to make more money; how the makers of armaments wanted bigger profits. So these people plunged into the war, and at their bidding, and that of the elderly politicians representing them and their class, the youth of the nations rushed at each other's throats. The vast majority of these young men, and the common people of all the countries concerned, knew nothing of these causes which had led to the war. They were really not concerned, and whether success came or failure, they stood to lose by it. It was a rich man's game played with the lives of the people, and mostly of the young.[15]

In the Versailles Treaty which concluded the First World War, the same powers that were responsible for the war sold the people down the river with a peace that made another war inevitable. The eyes of the American people were opened to some of the realities of imperialism. Our people had fought with high idealism "to make the world safe for democracy," only to be disillusioned by the machinations of scheming imperialists at the peace conference. President Wilson went to this conference with hopes of establishing a just peace and a League of Nations to administer it; but at every turn he met the opposition of wily diplomats who were after the spoils of war. Great Britain got most of the German colonies; France got the rest, and a part of Alsace and Lorraine; because she was weak, Italy got little of what she had been secretly promised; although Russia had suffered more in the war than any other power, she lost important strategic areas because she turned to communism; Austria-Hungary was dismembered and a group of small states were created. The Americans, it now appeared, had been fighting not for democracy but to turn victory from one group of imperialist powers to another. Generally disillusioned, they turned away from Europe, resolved never to become involved in European squabbles again.

The Second World War was to some extent a war of "ideologies," at any rate in the minds of plain people. Yet the longer it lasted, the more obvious it became that to the British Foreign Office and our own State Department it was not altogether or even mainly a war against the brutal and barbarous principles of Fascism, but in some degree an imperialist struggle for colonial possessions, markets, and raw materials. Fascism, as we shall presently see, was in one of its aspects a reactionary movement designed to destroy democracy, particularly labor unions, in the interests of powerful business leaders and aristocrats. Rather naturally, when Mussolini and later Hitler, with the help of industrialists and army officers, proceeded to wipe out labor unions, kill or imprison socialists and communists, and reduce the masses to subordination, the aristocratic Tory government of Great Britain was at first rather friendly to them, as were certain aristocrats and business leaders in France and other countries. Fascism, which had broken up the unions and reversed the trend toward democracy in Italy and Germany, looked like the answer to the prayers of the industrialists and aristocrats, particularly since the Fascist gangsters posed as the indefatigable defenders of Europe against communism.

But when it presently appeared that Mussolini and Hitler were aiming not only at the unions and democracy but at conquest of the other European powers and their empires, Great Britain and France were obliged to fight. They did not fight because Fascism was undemocratic, but because it threatened their colonies and, indeed, their very existence as nations. So too the United States had made no effort to stop the Japanese invasion of China and had sold Japan the iron and steel and oil with which to wage war; but when Japan struck at Pearl Harbor, we were forced to fight—after having helped to arm her for the war against us. Although the governments of Great Britain, France, and the United States had shown no particular hostility to Fascism, they would defend their possessions. The war proved to be largely an imperialist war, with the "have" nations—England, France, the Netherlands, and Belgium—defending their possessions and themselves against the "have-not" nations—Italy, Germany, and Japan.

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[15] Jawaharlal Nehru, *Glimpses of World History*, p. 625. By permission of The John Day Company, Inc., publishers.

There were pious platitudes about the "Four Freedoms," but there was no thought of extending these freedoms to the colonies of the imperialist powers, just as in the United States there was little pretense of extending to Negroes the "freedom and democracy" that served as a battlecry in the war. Negroes were drafted for the armed forces, but some of them seemed to have unaccountable difficulty in finding out what they were fighting for, except the accustomed "Jim Crow" privileges.

Thus imperialism has been an important factor in many wars. Capitalism, particularly what is often called monopoly capitalism, is strongly expansive. Modern industry is vastly productive, and foreign markets are demanded for the goods produced; great capitalist combinations are profitable, and foreign investments are needed for surplus savings; industrial production calls for vast amounts of raw materials, and foreign supplies of them may be required. Capitalists inevitably clash in their quest for foreign markets, investments, and raw materials; and since they are usually backed by their governments, which they largely control, wars result.

Other elements enter, of course—patriotism, national conceit, lust for power, a natural distrust or dislike of foreigners, a real liking for the "pride, pomp, and circumstance of glorious war," and in some cases a wave of sympathy for oppressed peoples. The people of the United States supported the Spanish-American War partly because they were flamingly indignant at the treatment of the Cubans by the Spanish government; and sympathy for the Belgians undoubtedly had much to do with our entry into the First World War. But, as a rule, such factors are not the most fundamental ones in bringing on wars, and they are themselves in part fomented and instigated by the capitalists who have imperialist axes to grind. Some years ago certain American oil men who were having trouble with the Mexican government raised a half-million dollar slush fund to be used in stirring up hostility to Mexico. It is often easy to make an imperialist adventure look to the people like a patriotic national undertaking. Furthermore, imperialist governments are not always averse to holding up war as a continual menace. They do not want actual war, but they may find threats of it to their advantage, for, as Anatole France says, people who are living under such threats demand few reforms, do not haggle over war expenditures, submit obediently to authority, and are generally easy to govern.[16]

It should be noted that the imperialist powers are less warlike than they once were. They may indeed pounce upon helpless colonials without much hesitation, but they try to avoid fighting other powerful nations. The capitulation of Great Britain and France to Hitler's threats at Munich indicates this clearly. They seemed willing to surrender almost anything to avoid war—almost anything but their colonial possessions. But this means only that the nations which have what they want do not care to fight for more, and would be glad if everyone would stop fighting—somewhat as a man's manners are usually better after dinner than before.

Imperialist wars and other wars

Even if we concede that economic imperialism, a characteristic vice of capitalism, has been the cause of many of the wars of the past two or three centuries, we need not conclude that under any economic system other than capitalism wars could be avoided, or that they would necessarily be less frequent or less brutal. There were terrible and almost incessant wars in some parts of the world before the capitalist era. In ancient and medieval times, wars followed each other with little intermission. Some of the books of the Old Testament are largely histories of the wars of the Israelites, many of them carried on with savage brutality. Certain of the Crusades were carnivals of bloodshed, and some 2,000,000 people are estimated to have been killed in the religious wars of the Hugenots in France. In an excess of religious enthusiasm, the Duke of Alva inflicted unimaginable sufferings on tens of thousands of the people of the Netherlands during the sixteenth century. "In less than three months he had put eighteen hundred people to death. On one occasion five hundred were burned en masse. On February 16, 1568, the Holy Office issued a decree condemning every inhabitant of the Netherlands to death as heretical. . . . Literally this meant the massacre of three million people—too large an order for even the bloodthirsty Duke of Alva. But he did his best and wrote to Philip informing him that at the 'close of Holy Week eight hundred persons are to be executed.'"[17]

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[16] See D. U. Brogan, "Capitalism and War," *Harper's Magazine*, July, 1936.

The Thirty Years' War, a religious war, reduced the population of Germany from some 16,000,000 to 6,000,000, of whom 350,000 perished by the sword, the rest dying from famine and disease, or migrating to other countries. In the Lower Palatinate, only one-tenth of the inhabitants survived; in Württemberg, one-sixth; in Bohemia, one-fourth.

Primitive people are often, although not always, warlike. The Indians of North America, with their simple economy, communistic in some respects, waged war with each other a great deal. Some of the primitive peoples of the South Pacific are peaceful; but others, as for instance some of the head-hunters of Borneo and New Guinea, engage in frequent raids, not in quest of markets or raw materials in the fashion of imperialist powers, but in search of human flesh to eat and of human heads for home decoration. To some this seems worse than economic imperialism.[18]

The isms, imperialism, and war

Fascism is of course far more warlike than capitalism, and Fascist imperialism more brutal than capitalist imperialism. Indeed Fascism, in one of its aspects, is inflated imperialism raised to the *n*th power in the energy with which it pursues its aim of national aggrandizement, and debased to the level of Roman imperialism in the brutality with which it operates. The Nazis sought markets for goods and capital, and raw materials, as well as world power; and they had the characteristic imperialist disregard for the personality and rights of other peoples. Had they succeeded in achieving world domination, there would have been no peace.

Communism as expounded by Karl Marx was essentially pacifist, hostile to foreign wars; for Marx believed that the enemies of the laboring classes were not the people of other countries but the employers at home. It is therefore not surprising that in the quarter century between the two world wars, the Russian communist government had a better record in peace efforts than the governments of Great Britain and France. Busy with her internal construction problems, Russia worked hard for peace most of the time; yet, facing the hostility of the capitalist powers, Great Britain and France, as well as of Germany, she was obliged to devote much of her energies to preparing for war. Her war on Finland in 1939 had a semblance of justification in the fact that Leningrad was dangerously near the Finnish border, and Russia had reason to believe that Finland might be used by enemy powers as a springboard for an attack—as happened later. Since her emergence from the war as one of the world's great powers, she has turned to a more aggressive foreign policy; but it is doubtful if Russian imperialism offers a serious threat to world peace in the calculable future.

Democratic socialism is essentially pacifist, anti-imperialist; and many socialists believe that there will never be stable peace in the world until most of the great powers have turned to socialism. They argue that since there would be no powerful capitalist interests in a socialist state, there would be no economic imperialism and no occasion for wars. There is doubtless some validity in the argument; yet there would be international rivalries, whatever the form of government, and they might lead to wars.

Imperialism and the peace settlements

Imperialism offers a deadly threat to peace plans. Colonial peoples are growing more and more rebellious, more and more insistent on their right to freedom and some of the good things of life; but, except for the United States —and Germany, Italy, and Japan, under compulsion—none of the imperialist powers has moved to give up its colonies. Winston Churchill once declared that he had no intention of presiding over the liquidation of the British Empire, and later he confessed that as the war progressed it became less and less a war of ideologies—which presumably meant that it was more and more an imperialist war. The recent election of a socialist government in England suggests, however, that Britain may veer away from her traditional imperialist policy, may treat her colonies with greater consideration, possibly even free some of them. If she should do this, the outlook for world peace would be much brighter. The white man's control over the vast populations of Asia is going to be harder to maintain in the future.

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[17] A. H. Verrill, *The Inquisition*, p. 235. By permission of D. Appleton-Century Company, Inc., publishers.

[18] See C. C. Miller, *Black Borneo* and *Cannibal Caravan*.

At the present time the United States seems headed for a strongly imperialist policy. With our oil reserves dwindling each year, the government is looking about for additional reserves wherever they can be found. Not long ago the government announced a plan for the exploitation of oil in Arabia, by which it was to spend a large sum in building a pipe line and two American oil companies were to produce the oil, one billion barrels of which was to be reserved to our government. This is imperialism of a peculiar type, for the oil companies agreed to the plan only under pressure from the government. This scheme still lacks the approval of Congress and of the Arabian authorities. In other ways too our imperialist trend is becoming evident. Important political leaders are already demanding that we retain the islands and air fields in various parts of the world which we have gained through lease-lend or conquest; and some fairly loud voices are trumpeting America's mission to take a leading part in keeping the world in order, with or without the cooperation of other nations. More moderate views will perhaps prevail eventually; but with the greatest air force in the world, and with a navy greater than the combined fleets of all other nations, the United States may feel that her greatness calls for more room in the world. Our development of the atomic bomb will no doubt strengthen our imperialist spirit.

QUESTIONS

1. Define economic imperialism. Why has the United States been less inclined to imperialism than Great Britain? Trace the history of American imperialism.
2. "The Revolutionary War was largely a fight against British imperialism." Explain.
3. How may imperialism benefit the subject peoples? Would not the people of Borneo gain from being required to adopt American customs? Why did not the Filipinos like our superior government?
4. Is not capitalist economic imperialism more humane than the imperialism of ancient Rome? How does it compare with German and Japanese imperialism?
5. "We could abolish imperialism if we could change human nature." Is there no other way of abolishing it? Why are the manners and morals of nations so much worse than those of individuals?
6. "Little more than 200 years ago a Te Deum was sung in St. Paul's, specially composed by Handel for the occasion, to celebrate the Peace of Utrecht which gave England a practical monopoly in the slave trade from West Africa to America."[10] Is there anything peculiar about this, or about the fact that some slave traders professed strong religious faith?
7. What is the relation between monopoly and imperialism?
8. Was World War II an imperialist war? Why or why not? Is the war to be explained, to some extent, in other terms? Discuss fully.
9. What is meant by "inner imperialism"? Give an illustration of it. Is it beneficial to the "colonial" areas?
10. Why are long-time imperialist nations, like Great Britain and France, usually anxious to preserve the peace? Were they always?
11. How does the spirit of imperialism offer a serious threat to postwar peace?
12. Why are British laborers willing to fight and die to perpetuate the British Empire and save the colonial investments of British imperialists? Would the laborers lose anything if Great Britain lost her colonies?

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[10] Hartley Withers, *The Case for Capitalism*, p. 20.

Chapter 39.

The Decline of Capitalism

At various points in the foregoing chapters we have pointed out that capitalism, like biological organisms and like other human institutions, is an evolutionary institution, that it has changed in passing from one stage of its development to another. There is some reason to believe that it is now an "old" system in its last stages, and that it will presently be greatly modified or entirely abandoned.

Many will resent the suggestion that capitalism may be on its way out. For more than two centuries, a period of astounding economic progress, all the important countries maintained a capitalist economy; and to many people it has seemed as natural as the balance of the solar system, as stable as the Rock of Gibraltar. In some respects, furthermore, it has achieved its greatest triumphs in recent years, in advances in technical efficiency, mechanical speed and precision, mass production at low costs, and the attainment of the means for providing what philosophers have dreamed of for ages, a good economic life for all.

Most of the American people, and perhaps the majority of our economists, still view the Great Depression merely as one of the cyclical recessions which have always characterized the capitalist economy, a recession which persisted because of the chaotic world situation and the unwise domestic policies of the New Deal. It is quite true that if international relations were friendly, if international trade were on a normal level and the nations of the world were engaged in peaceful, productive work, our economy would work far better; but the Second World War itself represented one aspect of the world-wide breakdown of capitalism. Although some of the New Deal measures doubtless tended to make the revival of private business more difficult, it must be remembered that the New Deal was itself the result of business paralysis and mass unemployment, for the widespread distress of 1932 led the people to demand that the government "do something" to mitigate suffering and set the wheels of industry turning again; and they repudiated President Hoover because he followed a generally "laissez-faire" policy, relying on capitalism to make its own recovery. What would have happened if this policy had been followed rigorously, whether we should presently have pulled out of the depression or remained in it, is impossible to say.

The New Deal

Certainly some of the measures included under the New Deal could not possibly have contributed to sound recovery from a depression. The National Industrial Recovery Act was designed to restore the confidence of businessmen by encouraging them to form trade associations for the various industries and draw up their own "codes" of fair business practice, under a certain amount of government supervision. It soon appeared, however, that the codes were employed as devices for stifling competition and raising prices. Rigid monopoly prices were one factor in the business paralysis, and here was the government trying to increase the number of such prices, while consumer demand could certainly not be stimulated by a rise in the prices of consumers' goods. Business confidence could not be expected to lead businessmen to produce goods which could not be sold.

The labor provisions of the New Deal, although possibly justified as reform measures, could not have been generally effective as means of curing a depression. The NRA codes contained provisions raising some wages and limiting hours of work, thus increasing the manufacturers' costs—surely no way to tackle a depression. Section 7-A of theRecovery Act affirmed the right of labor to form unions; and the National Labor Board, and the National Labor Relations Board, established a little later, expanded the protection afforded labor unions; but the fostering of unions was no way to relieve the depression, however well justified it may have been for other purposes. On the contrary, since one reason for industrial stagnation was the too high wages paid some classes of labor, the encouragement of labor unions was likely to have a depressing effect. The New Dealers were infected with the notion that higher wages would increase the amount of purchasing power in the hands of consumers, an idea which was the reverse of the truth; for, as was brought out earlier, reduction of wages has usually been one of the conditions essential to recovery from a depression.

Whether the Agricultural Adjustment Act, which provided subsidies to farmers for reducing production, stimulated or retarded recovery cannot be answered definitely; but it may have had some tendency to hasten it. Many farmers were in desperate straits, and AAA payments were used mostly to buy consumers' goods. In 1934, soon after the AAA was set up, the central part of the United States suffered a drought, the worst in more than half a century; and this was followed by several dry years, with the result that farm production was curtailed far beyond the plans of the AAA.

Certain other New Deal measures may well have contributed to economic recovery. The devaluation of gold, the purchase of silver, and other measures designed to raise the price level may have been partly responsible for the price rise which set in soon after President Roosevelt assumed office. This rise tended of course to reduce the burden of debts and to enhance business profits. Relief and wage payments under the Public Works Administration and the Works Progress Administration increased consumer purchasing power and so encouraged immediate recovery, although their final effect may well have been to retard sound recovery by preventing needed adjustments in wages.

Although it is difficult to make a fair appraisal of the New Deal measures, most economists would probably agree that while they did give our economy a "shot in the arm" which provided a brief exhilaration, their general result was to delay sound recovery. This was not, as was occasionally charged, because President Roosevelt was out "to destroy the capitalist system" but, as Keynes once pointed out, because he aimed at both recovery and reform, and the reform measures to some extent obstructed recovery. Whether our economy would have revived sooner if there had been less government tinkering or if the tinkering had been managed wisely and with the single purpose of promoting recovery, cannot be answered dogmatically. We know only that there was no real recovery until we became active in the Second World War. In 1936 and 1937, business made a sudden spurt which for a short time looked like real recovery, but within a year it slid back to depression levels in one of the steepest declines in the history of our country.

For eleven years—from 1929 to 1939—the American economy remained in a state of depression. Every start toward recovery soon fizzled out. This could hardly have been due mainly to unwise New Deal measures, for most other capitalist countries were similarly afflicted. Shall we say, then, that we were merely failing to emerge from the worst depression in our history, or that our trouble was more fundamental, the decay of our capitalist system? We need not make a definite choice, for both questions can be answered affirmatively. To some extent, we failed to pull out of the depression because our capitalist system was no longer basically sound, somewhat as a man whose vitality is low often dies of a disease which he could easily have thrown off had he had greater vitality.

Pessimism regarding capitalism

That the capitalist system is in the "sear, the yellow leaf," is the opinion of a considerable number of the ablest students of the social sciences. Socialists, commonly prophetic of vision, have insisted since the time of Karl Marx that capitalism must bow out, to be succeeded by socialism. In 1921 H. G. Wells wrote pessimistically of "the progressive break-up of the civilized organization that is going on."[1] John Strachey entertains no doubt that "the capitalist system is dying and cannot be revived. That is the conclusion to which any honest investigator of the actual facts and possibilities of the present situation must be driven. . . . The age of individualistic freedom is very nearly over."[2] G. D. H. Cole asserts unequivocally that capitalism in Europe is "a dying force which has already demonstrated its incapacity to take upon itself the necessary tasks of collective organization," although he believes that its revival in the United States is possible.[3]

This view is not confined to socialists. A. H. Hansen, an able student of business cycles, has expressed the opinion that the Great Depression was not fundamentally cyclical:

> This depression is of a magnitude and duration which has eclipsed all others, not excepting even the deep and prolonged depressions of the seventies and nineties. It is a unique phenomenon. It cannot be explained in terms of ordinary business-cycle analysis. For the time being at least we are experiencing a chronic maladjustment, a failure of adequate outlets for capital expenditures for a society geared to a high savings, high investment level. We are caught in the midst of powerful forces in the evolution of our economy which we but dimly understand. Something has gone wrong with the forces making for expansion. We are undergoing a fundamental change in the structure of our economic life.[4]

Frank Knight goes even further:

> For the first two years or so after the economic crisis of 1929, I was one of the large group of students of economics who condemned the idea that this was fundamentally different from other depressions. But I have become convinced that I was in error, that we are actually in the course of one of the world's great economic and political revolutions. Even if we see some business revival, it will be limited and temporary. The nineteenth-century liberal system is played out, and the world of West-European civilization, based on political "democracy" and economic "freedom," will go through a drastic revaluation of its "modern" ideas and values.[5]

Paul Douglas, slightly less pessimistic, believes that the capitalist system might survive two or three more depressions, but probably no more. Joseph A. Schumpeter believes that capitalism will be replaced by socialism, perhaps tinged with Fascism, but sets no dates for the transition.[6] George Soule wrote confidently in 1934 of "the coming American revolution."

According to A. R. Burns, "The rise of the 'heavy industries,' changes in methods of selling, and the widening use of the corporate forms of business organization are bringing, if they have not already brought, the era of competitive capitalism to a close."[7] Sir Arthur Salter believes that capitalism is on the way out and that we are now in a stage of transition to some other kind of economy.

Herbert Heaton, an economic historian, is equally pessimistic about the state of capitalism:

> Is there a general inherent rigidity in modern capitalism, or in the modern forms of capitalism, which impels it in a certain unchangeable direction to destruction or at least to drastic transformation. Marx was sure there was; and Sombart was equally sure, two decades ago, that modern capitalism had passed through infancy, youth, and exuberant manhood to middle age, and was approaching senility. He saw its hair graying, and its teeth falling out. Perhaps today he would say that its hair has turned gray overnight from the shocks of the last ten years and that its teeth have been knocked out in a concentration camp. It is certain that the rigidities cre-

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[1] H. G. Wells, *Social Anticipations*, p. 117.

[2] John Strachey, *The Coming Struggle for Power*, pp. 155, 156.

[3] G. D. H. Cole, *A Guide Through World Chaos*, p. 519.

[4] Temporary National Economic Committee, *Hearings*, Pt. 9, p. 3503.

[5] Frank Knight, in *University of Toronto Quarterly*, July, 1934, p. 411.

[6] Joseph A. Schumpeter, *Capitalism, Socialism and Democracy.*

[7] A. R. Burns, *The Decline of Competition*, p. v.

ated by the system itself during the last fifty years, plus those imposed by a depressed world, by an ideology-bound world, by a world preparing for war, and by a world which believes that political means can work economic miracles, have produced an economic order which is far remote from the classic capitalism of the Victorian age. It is equally certain that the forces which drove and dominated that classic age seem to be spent.[8]

Huizinga, looking at our present civilization from the cultural as well as the economic point of view in 1936, was similarly pessimistic: "The road of Roman civilization was a road to barbarism. Will it turn out to be the same road we are on today? Whatever historical comparison may afford for an understanding of the present crisis, it can give us no assurance regarding the latter's outcome. The confident conclusion that things will right themselves somehow is not warranted by any historical parallel." Oswald Spengler's views, as expressed in his *Decline of the West*, are too well known to call for elaboration. The "decline" he refers to is not merely a decline in capitalism, but a general decline of western civilization and power. Frederick L. Schuman also takes a broad view of the situation facing us: "Western civilization is already old. It may already have run its course and be headed toward a long twilight of decline. In any case, its problems are immediate, pressing, threatening. They will be solved within the next few decades, or they will not be solved at all. . . . No realistic observer can afford to be optimistic over the prospects." H. G. Wells, whose record as prophet is probably better than that of any other living man, now offers us no hope of maintaining civilized life or, for most people, any life at all: "The writer sees the world as a jaded world, devoid of recuperative power. In the past he liked to think that man could pull out of his entanglements and start a new creative phase of human living. In the face of our universal inadequacy that optimism has given place to a stoical cynicism. Man must go up or down steeply, and the odds seem all in favor of his going down and out. . . . Ordinary man is at the end of his tether and only a small, highly adaptable minority of the species can possibly survive—the rest will not trouble about it, finding such opiates for consolation as they have mind for. . . . The end of everything we call life is close at hand and cannot be evaded. . . . There is no way out or around, or through the impasse. It is the end."[9]

The shift from capitalism to other systems

We need not guess that capitalism is declining; we *know* that it is gone in some very important countries. Russia has turned to communism, Mexico has gone far toward socialism; Argentina, Brazil, and Peru have turned to Fascism; Turkey has a dictatorship which, although not definitely Fascist or socialist, is not laissez-faire capitalism; China is partly Fascist and partly communist. The United Nations have rescued much of Europe from Fascist control but seem inclined to set up new governments which have a Fascist tinge.

One of the United Nations' postwar problems is unemployment, which most of them were unable to solve before the war. They may be able to solve it, for the problem is not hopeless. Yet the war, which greatly reduced the volume of unemployment, added further difficulties of various kinds—public debts, for instance—which must be met. War is often a destroyer, not only of men and materials but of traditions and institutions. In fighting, furthermore, the capitalist nations were obliged to adopt to some extent the Fascist dictator principle, and it is not certain that they will ever be able to return to the free capitalism of the prewar period.

With all its great achievements, capitalism shows unmistakable signs of senility and decline. In most capitalist countries, including the United States, the economic system has operated less satisfactorily to large classes of people than it once did—to laborers, who are faced with the persistent specters of unemployment, insecurity, and hunger in the midst of plenty; to farmers, some of whom have lost their farms, others of whom are heavily and in many cases hopelessly in debt, and all of whom are burdened with heavy taxes and in normal times must sell their products on an overstocked market, at least in this country; to many businessmen, who face declining opportunities for individual enterprise, rising taxes, growing difficulty in finding satisfactory investments, and increasing government interference in business; to all who are interested in the stability of government and who see the public debt rising at a rate which threatens its final repudiation. As a result of these various conditions, there has been a rise in economic and social tensions, a sharpening in the class struggle, a rising tide of radicalism countered by a mounting spirit of fear and anger on the part of the business classes.

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[8] Herbert Heaton, in American Economic Review, *Papers and Proceedings*, March, 1940, p. 318.

[9] J. Huizinga, *In the Shadow of Tomorrow*, p. 36. Kansas City *Star*, November 5, 6, and 8, 1945.

Looking back over history, we need not be surprised if capitalism proves to be only a passing phase in human organization. While some private business has existed at various times and places through much of recorded history, capitalism in the sense of "big" capitalism—factory and machine capitalism as we know it today—has existed for only two or three of the fifty or sixty centuries of history. Werner Sombart, one of the leading authorities on capitalism, thought it "a peculiar episode in the history of mankind"; and Frank Knight believes it possible only because of "a remarkable accidental and inherently temporary set of conditions."[10] Clearly there is nothing "natural" or "inevitable" about it, no reason to assume that it must persist forever; on the contrary, there are strong reasons for believing that it will not last, and may even now be on the way out.

We can perhaps gain perspective on our problem by noting some of the economic conditions on the frontier a few generations ago, when capitalism operated satisfactorily to nearly everyone. The pioneers came west with the simple acquisitive ideal, the hunger for land, which they could get free or for a very small price; they were individualistic, self-reliant, restive under restraint, and since nearly all owned something, they were troubled with no disquieting doubts as to the sacredness of private property. Since almost all were poor, they started nearly equal, without the cumulative distinction of inheritance; relatively isolated, they were to some extent immune to exploitation by the great financial centers; unable to mortgage their homesteads during the first few years, they were free from mortgage debt; and local business concerns were small and individually owned. Their land was new and productive; and the problem of conservation, which always demands collective action, had not risen. As long as they saw their fortune growing, they were content with the world as it was—that is, with capitalism.

Here then are some of the conditions essential to the success of a capitalist order; a few others should be added to adapt our analysis to the broader national and world economies. We shall try to ascertain the causes of the decline of capitalism by considering the various conditions essential to its successful operation, and noting the extent to which those conditions no longer prevail.

REQUIREMENTS FOR A SOUND CAPITALIST ECONOMY

A sound, vigorous capitalism should meet the following specifications: (1) it should be largely competitive; (2) prices should be reasonably, and as nearly as possible equally, flexible to permit ready adjustment to changing conditions; (3) money should be sound, and the price level as stable as possible; (4) credit should be used sparingly; or, in other words, debts should not be too heavy; (5) inequalities in wealth and income should not be too great; (6) most business should be carried on by individual entrepreneurs, rather than by corporations; (7) there should be room for physical expansion; (8) international relations should be stable, and international trade as free as possible; (9) the government should not intervene in such a way as to discourage individual enterprise or interfere with adjustments in prices or production; and (10) the people must really *want* to retain capitalism, must understand the forces which are undermining it, and must set themselves resolutely to the task of maintaining it. The first four of these will be discussed in the present chapter; the others will be taken up in the following chapter.

1. Need for competition

A stable and satisfactory capitalist system should be largely competitive. It need not be entirely competitive, for no economic system ever was; but monopoly is a flaw in a capitalist system, and too much of it has unfortunate results, as we have already seen at various

[10] See Wesley Mitchell, "Sombart's Hochkapitalismus," *Quarterly Journal of Economics*, February, 1929, pp. 303–323.

points in this book. In the first place, it increases inequality in wealth and income, in some cases to the point where the small class of rich monopolists are unable to find investments for their large savings, while the masses of the people are unable to buy the products of industry. In the second place, as we have noted repeatedly, monopoly reduces the output of monopolized goods and, by forcing labor and capital into competitive businesses, creates relative overproduction in those lines. Some students of economics insist that the prevalence of monopoly in industry, and its tendency to restrict production, have made our capitalism a "scarcity economy." Reduced production naturally means high prices for monopoly goods, and the relative overproduction of competitively produced goods drives prices too low. Monopoly prices are not only high but "sticky," that is, unresponsive to changes in business conditions and in the general price level; this is one of the reasons for the persistence of depressions. Thurman Arnold has summarized all this concisely: "Thus the four horsemen—fixed prices, low turnover, restricted production, and monopoly control—rode through our economy from factory to farm."

Our economy is lopsided, badly balanced; a part of it more or less monopolized, and a part of it highly competitive; one part of it skimps production, raising prices and holding them up through fair days and foul, and the other produces generously and dumps goods on the market without reservation, often with little regard even to cost of production. This would be bad enough, but there is another flaw—the wide range of monopolistic competition. Here too producers are characteristically averse to price competition. Instead of cutting prices in the good old classical tradition, they maintain them, add gadgets and gimcracks and gilt and tinsel, and batter consumers with meretricious advertising appeals, in a rising spiral of marketing costs.

Is monopoly increasing? Whether the monopolistic element in our economy has been growing or not is hard to determine. Most socialists assume that it has unquestionably been increasing, and they often speak of capitalism in its present stage as monopoly capitalism. A. R. Burns, in his book, *The Decline of Competition,* piles up much evidence to support the conclusion that competition is declining; and Fetter, in his *Masquerade of Monopoly,* unequivocally takes the same position. Gardiner C. Means emphasizes as a cause of the decline of capitalism the growing significance of "administered prices"—prices which are fixed not in a free competitive market as the price of wheat is, but by the individual producers themselves. These are not quite synonymous with monopoly prices, although monopoly prices are always "administered."[11]

On the other hand, W. I. King has written caustically of the "monopoly bugaboo"; and Rufus Tucker, who made a statistical study of monopoly, came to the conclusion that administered, "sticky" prices were as serious a problem in 1844 and 1879 as in 1939.[12] Tucker points out that the price of Studebaker wagons and buggies, for instance, remained unchanged for years. In their study, *Industrial Price Policies and Economic Progress,* Edwin G. Nourse and Horace B. Drury go even further, for they declare that there is a trend away from monopoly, that there is more competition in the economy than there used to be.

With the ablest students of monopoly divided on this question, we cannot hope to answer it with much assurance. It is difficult to preserve an accurate perspective on such a broad and complicated problem, because it involves a comparison of the entire economy of the present with an earlier economy; and we cannot look at the two with the same eyes, for we know much more about present-day monopoly than about that of a generation ago.

Some of the characteristics of present-day industry do suggest the possibility that, in some respects and in some economic areas, it may be increasingly competitive. The vast multiplicity of products and processes should tend to make it so. When there are hundreds of different brands and qualities of many products, each a more or less satisfactory substitute for the others, monopoly should logically be more difficult to establish than when there were only a few products. At one time, for instance, the local grist mill was practically the only source of flour for consumers in a community, and bread was a far more important item in the diet than it is today. The grist mills were therefore in a strong monopoly position. Today the consumer may choose bread from any of a dozen brands, or flour from any of a hundred brands or from several different grains, or he may find a partial substitute for bread in any of hundreds of other foods, as indeed he tends more and more to do. Something like this is true of a great many products commonly used.

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[11] Gardiner C. Means, *Industrial Prices and Their Relative Inflexibility,* S. Doc. 13, 74th Cong., 1st sess.

[12] *The Burroughs Clearing House,* August, 1927, p. 5; *The Annalist,* February 4, 1938, p. 195.

In some businesses, competition is certainly more vigorous than it once was. The retailer of a generation ago, in line with the rather slow and traditional methods of the time, did not go after business as aggressively as the merchant of today. To survive at all in the retail battle today, a merchant has to work hard.

Other factors, on the other hand, suggest that competition should logically be declining. One of the most important is the growing number and significance of industrial products as compared with farm products. Farming represents the most definitely competitive section of our economy, whereas industry is monopolistically competitive, or monopolized; thus the relative increase in industrial products means that the proportion of the total economy which is infected with monopoly is growing.

Increasing domination of the economy by a few giant combinations also suggests that monopoly is growing. In competitive capitalism there should be a considerable number of competitors, not too unequal in financial power, for there can be fair and vigorous competition only if this condition prevails. An increasing portion of our economy no longer fits these specifications. The tendency for decades has been for a steadily decreasing number of producing units to turn out a steadily increasing output. It is sometimes argued that a few large concerns may compete as vigorously as many small ones—as they did, for instance, in the automobile tire industry—but certainly it is easier for a few to combine into definite monopoly, or at any rate to follow a gentlemanly policy of "live and let live" for their business rivals; furthermore, even if there were no monopolistic agreements, the great size of the units in some of our industries would make it difficult for any but powerful business concerns to enter them. One of the assumptions underlying a competitive economy is that there shall be free entry and withdrawal into and from industry; and the former can hardly be maintained when a new plant costs many millions.

The changing character of monopoly. Whether monopoly is growing or declining in amount, its character is certainly changing. There has always been some monopoly in our economic life; but in the days when communication and transportation were slow and inefficient and communities were to some extent isolated and self-sufficient, such monopolies as existed were small, scattered, and relatively numerous. With the development of efficient communication and transportation and the consequent growth of nation-wide markets and great industrial plants in the urban centers, monopoly, like industry itself, became centralized on a nation-wide scale. The telegraph, railroad, radio, airplane, automobile, bus, truck, and good roads destroyed many little local monopolies—the grist mills, iron forges, and other small industries scattered over the country—and created a relatively few large ones—the giant flour mills, steel mills, and other industrial plants characteristic of our present system.

Even if, relative to the competitive area, the monopolized market area were no greater than it used to be, monopoly would still be more serious, because people are in the market so much more than they used to be. With increasing division of labor, increasing specialization, and increasing output of goods, people buy and sell much more than they did even a generation or two ago, and monopoly prices consequently affect them much more.

Labor monopolies. Labor monopolies as well as capital monopolies have contributed to the decline of capitalism, and in much the same way. Some labor unions hold wages definitely above a competitive level and so contribute to unemployment. Slichter has stressed too-high wages as an important reason for the business stagnation from 1929 to 1939.

Too much weight should not be given monopolistic labor unions in explaining the recent paralysis of our economic system. Many businessmen charge labor unions with most of the responsibility for the fact that entrepreneurs lack confidence to engage more extensively in production, but this is unfair. In the first place, statistical evidence shows that in most industries the cost of labor per unit of product has been lower in recent years than it was in the early 'twenties, in spite of substantial increases in hourly wage rates.[13] In the second place, we have had labor unions for a century or more, and capitalism has stood the strain. Labor has been more generally unionized in the Scandinavian countries than in the United States, yet their capitalism is in a sounder condition than ours. The Scandinavian unions have a keener sense of social responsibility than many of those in the United States and have refrained from too greedy use of their power, but Scandinavian businessmen also have a keener sense of social responsibility than our own; indeed this is true of the people generally. It is unfair to emphasize labor conditions too much.

Statistical evidence on monopoly. The theory that monopoly is an important cause of the decline of capitalism is supported by a rather ambitious four-part study made by the Brookings Institution under the supervision of Harold Moulton.[14] According to this study, about 22 per cent of the capital equipment of the United States was idle, even in the prosperous years from 1925 to 1929; and in the ensuing depression years 1932, 1933, and 1934, our total production was only 55 to 60 per cent of capacity. The Institution estimated that if we had made full use of our productive plant from 1922 to 1933, we could have produced 248 billion dollars' worth more goods than we did produce.

Why this vast waste of productive capacity? Why, with an adequate plant at hand, is it impossible to produce the goods that the people want and need? According to traditional theory, entrepreneurs will see a chance to make a profit in productive operations and will put the capital and labor to work; but they failed to do this, even in the prosperous years from 1922 to 1929. The trouble was, therefore, not cyclical depression but the chronic failure of capitalism, which becomes more serious during a depression.

The difficulty, according to the Brookings Institution, was not that consumers did not want more goods but that most of them did not have enough income to buy the goods they wanted; and the reason for this was that too much of the total income went to a small class at the top who did not spend it but saved it, partly because they had more income than they cared to spend for consumers' goods. The large incomes of these few were in part monopoly profits.

All this would not necessarily be disastrous. If the few wealthy savers had invested their savings in new capital, in new and improved plant, the money would have gone to buy raw material and hire labor—would have circulated—just as truly as if it had been spent for consumers' goods; but even in the years of prosperity the savings were not all invested, and in the ensuing depression there was little capital expansion; instead, savings were "hoarded" as bank deposits or were used to finance government deficits or bid up the price of securities.

Why was this? Why were savings not invested in new plant? The Brookings Institution finds the answer in the fact that business is so generally monopolized that prices did not fall with declining costs, but were maintained at a level so high that the masses of the people, with their inadequate share of the total income, were unable to buy more goods, and therefore businessmen could not profitably build much more plant. Thus the breakdown of the capitalist process is engendered by too much monopoly, too high prices, too great inequality of wealth, too much savings, and too little investment in capital. The Brookings Institution naïvely suggests that the remedy is a general reduction in the prices of goods—which businessmen would of course be happy to make, once they thought about it.

Some statisticians and economists have criticized the Brookings report as to both the statistical data used and the general conclusions; but a more recent study by Mills seems to indicate some reason for believing that in recent years, through monopoly or otherwise, prices of consumers' goods have been maintained at a level higher than was justified by costs. Comparing the changes in productivity, costs, and prices during the period 1899 to 1914 and between 1914 and 1937, Mills finds that changes in the earlier period were such as theoretically should appear in a competitive economy, whereas those in the later period were such as we might expect in a more or less monopolized economy. Although he does not state this as a definite conclusion, it follows from his figures and analysis, which are well worth quoting:

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[13] See Theodore Kreps, in American Economic Review, *Papers and Proceedings*, February, 1941, p. 188.

[14] *America's Capacity to Produce; America's Capacity to Consume; The Formation of Capital;* and *Income and Economic Progress.*

"The increase of 30 per cent in productivity from 1899 to 1914, and the accompanying decline of 23 per cent in the productive effort required to fabricate a unit of goods, benefited consumer groups. Agents of fabrication, as producers, received only a small portion of these gains." This is what would be expected in a largely competitive economy. Competition would force producers to lower prices to a point where the gains of increased productivity and lower costs would go mainly to consumers.

> The increase of 50 per cent in productivity from 1914 to 1929, and the concurrent decline of 33 per cent in productive effort required to fabricate a unit of goods, operated largely to the advantage of producing groups. A substantial portion of the total gain in productivity went to manufacturing wage earners, as producers, while ownership, management, and other claimants scored gains actually exceeding the advance in productivity. Wage earners and salaried workers, as consumers, also benefited, but consuming groups drawing incomes from the sale of primary products were confronted with advances in the real costs of the manufactured goods they purchased.

Turning to the period from 1929 to 1937, a depression period, Mills concluded: "The increase of 24 per cent in output per man hour from 1929 to 1937, and the reciprocal drop of 19 per cent in the productive effort required to fabricate a unit of goods, operated chiefly to the advantage of producers. Wage earners in general, as consumers, gained materially, since hourly rates of pay were substantially advanced, and primary producers other than farmers enjoyed lower costs. But cost reductions to other consuming groups were negligible."

Of possible significance are other figures tending to show that in recent years industry has fallen far short of utilizing the increasingly efficient productive plant of the nation. As Mills put it:

> From 1899 to 1914 the potentialities of improved techniques were substantially realized. The increase in aggregate output was more than twice that in productivity. But the potentialities of the far more impressive technological gains during 1914–37 were not made effective in increased output, in the same degree. The notable productivity gains in manufacturing industries were not accompanied by corresponding advances in the aggregate output of manufactured goods. The output of manufactured goods in 1937 could have been produced by a working force less than 10 per cent larger than that of 1914. The actual population available for productive employment was, of course, much larger.[15]

Hacker is even more unequivocal in stating a similar conclusion. He believes that American capitalism was in a healthy condition as long as it remained "industrial capitalism"—until about 1900—but that from 1900 on, industrial capitalism was gradually supplanted by "finance capitalism"—the dominance of industry by powerful banks, holding companies, and other financial interests. "Finance capitalism operated—through the device of monopoly; and monopoly killed the expansive and progressive character of free industrial enterprise."[16]

Little, perhaps, can be done about monopoly, but its significance in our economic decline is so great that it should be vigorously attacked by every weapon available. In fact, Henry C. Simons maintains that every industry which cannot be made effectively competitive should be taken over by the government.

Not only has monopoly grown more important in our economy, but monopolistic competition has grown even more rapidly. Monopolistic competition is much like monopoly in many respects, for the monopolistic competitor, like the monopolist, faces a declining average revenue curve, and therefore has an inducement to restrict production in order to keep prices up. Our economy would work much better if monopolistic competitors could produce as abundantly and sell as cheaply as pure competitors. Many such goods would sell for one-half or even one-fifth of the prices regularly charged. Consumers could buy more, and so more could be produced and there would be more jobs. Monopolistically competitive prices are generally rigid as well as high, which impedes adjustment to lower price levels and so tends to prolong depressions.

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[15] Frederick C. Mills, *The Anatomy of Prices, 1890–1940*, National Bureau of Economic Research, Bulletin 80, p. 11.

[16] Louis M. Hacker, *The Triumph of American Capitalism.*

2. Need for price flexibility

In a vigorous capitalism prices should be reasonably, and as nearly as possible equally, flexible, because only when there is reasonable flexibility can the economic system adjust itself to changes in business conditions and price levels. There have been many complaints of "hardening of the arteries" in business in recent years. Various elements have tended to reduce the flexibility of prices. Monopoly has become more important, and monopoly prices are not flexible. Public utilities, which today represent an investment of some 50 billion dollars, including railroads, are vastly more important than they were even a few decades ago; and public utility rates are highly inflexible. More industries, even in those fields in which there is little taint of monopoly, maintain fairly stable prices today than formerly. There are more different industries now than there used to be; and with greater investment in fixed plant and machinery and consequently higher fixed costs, there is a stronger incentive for entrepreneurs, even in fairly competitive businesses, to avoid price cutting. A larger proportion of labor is unionized, and union wages change very slowly in response to changing economic conditions. The inflexibility in business prices is augmented by the inflexibility of government prices, which have rapidly increased in number. The government provides mainly services, rather than goods; but the cost of these services, which consists chiefly in the salaries of its employees, changes only slowly in response to changing economic conditions. Although the price level declined about 42 per cent between 1929 and 1932, the salaries of many government employees were reduced only 15 per cent, and some were not reduced at all. While business was somersaulting down to the paralytic level of 1932, government expenses, including relief, were actually increasing.[17]

Although there is some evidence to the contrary, it is probable that the proportion of rigid prices set by big corporate units, public utilities, and the government has increased considerably in recent years. In its final report, the Temporary National Economic Committee stated this conclusion clearly: "One of the primary causes of our present difficulties lies in the disappearance of price competition in many industrial fields, particularly in basic manufacture where concentrated economic power is most evident—and where rigid prices and fluctuating pay rolls are general."[18]

Frederick C. Mills reached a similar conclusion a decade or so ago: "Heavy investment in overhead, price regulation, monopolistic and semi-monopolistic control, trade agreements, changed distributive methods, emphasis on non-price factors in selling, extensive valorization efforts—these and other influences tended to render prices a less sensitive agency for the transmission of economic intelligence, and to make more difficult that prompt adaptation of individual economic elements to changes in other elements which is essential to the working of a competitive economy."[19] Kreps takes the same general point of view, as does also McCracken.[20]

3. Need for sound money and price level stability

A stable capitalism calls for sound money and a reasonably stable price level. Unsound money paralyzes business and creates unemployment, insecurity, and almost every other imaginable economic ill. Hitler and the Nazis rose to prominence shortly after the ruinous inflation of 1923. In every serious price deflation in our own history, on the other hand, there has been a turn toward radicalism, although never very serious. Karl Marx once said that one of the most effective ways of undermining a capitalist economy was to destroy confidence in its money.

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[17] Temporary National Economic Committee, *Monograph No. 21*, pp. 302–307; *Monograph No. 22*, pp. 190, 234.

[18] Temporary National Economic Committee, *Final Report and Recommendations*, p. 13.

[19] Frederick C. Mills, in *American Economic Review*, September, 1933, p, 553.

[20] H. L. McCracken, in *Southern Economic Journal*, October, 1938, pp. 158–178.

Was unsound money a cause of the Great Depression and the undermining of our capitalist system? Since the First World War we have had tons of gold; in this respect our monetary system is the soundest we have ever had. Gold and paper money, however, constitute only a small fraction of our total money supply, for 95 per cent of all payments are made by means of bank deposits, and bank deposits are a viciously unstable form of money. Bank loans, which amounted to over 42 billions in 1929, had declined to 27.8 billions in 1932 and to 22.2 billions in 1933; and this decline was accompanied by a proportionate deflation of bank deposits, or money. Bank deposits expand in times of prosperity, and so accentuate business booms, and shrink during periods of recession, and so intensify depression. Henry C. Simons boldly declares: "It is no exaggeration to say that the major proximate factor in the present crisis is commercial banking," with its perverse expansion and contraction of the money supply. "Capitalism seems to retain remarkable vitality; but it can hardly survive the political rigors of another depression; and banking, with the able assistance of monopoly, seems certain to give us both bigger and better depressions hereafter—unless the state does assume and discharge with some wisdom its responsibility for controlling the circulating medium."[21]

But if fluctuating deposit money is to be charged with the undermining of capitalism, it will have to be proved that in some way it has been a more important element in recent years than formerly. The proof is easily found. In the first place, although banks have long provided deposit money through the process of lending, the proportion of payments made through the use of deposits is much greater than it used to be. Money, cash, was in much more common use even a few decades ago. And in the second place, the price level has been tied to gold by a longer rope in recent years. Various provisions of the Federal Reserve Act of 1913 and of subsequent banking legislation made possible a greater expansion of credit, on the basis of a given amount of gold, than had previously been possible.

4. Need for discrimination in the use of credit

In a sound capitalist system, credit should be used sparingly and with discrimination. This is true for several reasons. For one thing, the interest payments on debts represent fixed charges expressed in dollars which, like sticky monopoly prices, do not change with changes in the price level; they may be very burdensome in a time of falling prices, for they absorb an increasing proportion of the purchasing power which should go to the purchase of commodities. If the debts themselves are paid when the price level is lower, they similarly represent a heavy burden on debtors, one which forces a reduction in the purchase of consumers' goods. The creditors who receive this money may of course buy goods with it, but creditors are less likely to do this than debtors, for many of them prefer to lend their money again. On the other hand, in a period of rising prices the use of credit operates in reverse, the debtors gaining and the creditors losing; and partly because of this, business is likely to be good when prices are rising. This usually winds up in disaster, however, because rising prices, declining burden of debts, and prosperity lead to unwise speculation and debt accumulation which help to bring a crisis, and they make it more severe than it would be if the debt burden were lighter. The extensive use of credit—the piling up of debts—increases the severity of business depressions, and so makes the capitalist system work badly.

There are other reasons why heavy debts interfere with the successful operation of a capitalist system. Many debtors lose their property, and there is a consequent increase in the number of propertyless people who have lower incomes and lower standards of living, and perhaps also a rankling sense of injustice which is likely to give rise to a demand for radical legislation which further reduces business confidence and weakens the capitalist system. During the Great Depression, 38 per cent of the owners of mortgaged homes were behind in their payments, and a large proportion of them lost their homes; total foreclosures between 1929 and 1936 amounted to nearly 5 billion dollars. As a result of the widespread debtor distress, state and federal mortgage moratorium laws were passed, forbidding foreclosures for from one to three years. Many debtors, however, were so heavily involved that a moratorium was only a reprieve; moreover, such laws could hardly be expected to brace the confidence of businessmen and encourage them to resume operations. In some localities the laws of property and contract were flouted by farmers who assembled at foreclosure sales with guns and pitchforks to prevent them being made.

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[21] Henry C. Simons, *A Positive Program for Laissez Faire*, Public Policy Pamphlet No. 15, pp. 15, 16.

Debts, both private and public, increased rapidly in the years preceding the Great Depression. Farm mortgages in the United States, for instance, increased from 3.3 billions in 1910 to 9.5 billions in 1928. Between 1912 and 1930, the total of urban real estate debt increased from 7 billions to more than 37 billions. In the decade 1912 to 1922, the aggregate of private long-term debts increased about 20 billions, or 64 per cent, and in the next eight years it rose by another 33 billions. Such debt increases were out of all proportion to the increase in national wealth. During the prosperous years of the Coolidge administration and the first year of Hoover's term, many people, including even some Wall Street financiers, came to the conclusion that the United States had entered a "new era" of sound, unshakeable prosperity; and a tremendous wave of speculative enthusiasm developed, resulting in an accumulation of debts unprecedented in the history of the country. The fear of debt, which had always characterized wise men since long before the time of Benjamin Franklin, seemed only an outworn superstition.

Along with the increase in long-term debts, there grew up a heavy burden of installment debt. More and more, people who could not pay cash bought on the installment plan—automobiles, tractors, combines, radios, refrigerators, life insurance, bonds and stocks, homes, anything and everything. The onset of the depression found many unable to make their payments, and the result was a general collapse of the extended fabric of installment credit, with trucks hauling vast quantities of reclaimed goods back to the stores. Some of this debt was promptly wiped out by repossession, but some of it—building and loan contracts for the purchase of homes, and life insurance contracts, for instance—called for payments over many years; and some debtors who held these long-term contracts struggled for years to meet their payments, piling up further debts but finally losing much or all of their equities.[22]

The student may not be accustomed to thinking of life insurance as a purchase on installments, but it is in some respects. The amount of life insurance in force has grown with extraordinary rapidity in recent years—from 8.6 billion dollars in 1900 to some 110 billion in 1938. The total premiums paid amounted to 4.1 per cent of the national income in 1929, a prosperous year; while three years later, in the depth of the depression, they amounted to 8.7 per cent of the national income, or more than twice as high. Here is a factor of some importance in our economic paralysis, for these fixed payments, which during a depression are paid in money that is much more valuable, force the policyholders to skimp drastically in their purchases of consumers' goods.

Private debts are not the only ones that have grown rapidly. Federal, state, and local governments have piled debts up recklessly. Robert Doane draws a very somber picture of our debt situation:

> We have been talking about the *Federal* government debt only, which is but a part of our total governmental agency indebtedness outstanding. When we add the debts of state, county, township, school district, water district, local and municipal governments to that of the Federal debt we then secure a grand total of what the people owe to themselves which represents a sum approximating that of the combined value of our total farm, industrial and commercial man-made productive physical assets. And it is these physical assets used for the production of all other assets that must ultimately meet this debt burden. Further, we will recall that this government debt rests on top of the long-term debts already outstanding against these same productive assets—a factor frequently lost sight of, and a factor which means that the full debt burden resting against this national productive plant actually *exceeds* the total full exchange value

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[22] National Bureau of Economic Research, *The Volume of Consumer Installment Credit, 1929–1938*,

of that plant—a condition that violates all sound economic procedures.[23]

When the economic cyclone struck us in 1929, we had more than 250 billion dollars of debts in the United States. This includes all kinds of debts. Corporations owed some 47 billions on bonds; the federal, state, and local governments owed 32 billions on tax-exempt securities; mortgages on farm and city real estate amounted to 40 billions. Life insurance companies owed their policyholders some 12 billions, commercial banks were in debt to their depositors 47 billions, while savings banks and building and loan associations owed an additional 14 billions. The total short-term debt owed to banks and non-financial corporations came to 53 billions. In the next three years the price level declined some 42 per cent, which meant that the value of the dollars in which these debts were stated, and therefore the debt burden, rose about 70 per cent. The interest payments on the long-term debts alone, which in 1929 absorbed 6.3 per cent of the national income, called for 12.5 per cent of it in 1932.

The conclusions of the Twentieth Century Fund report seem sound: "Our debt difficulties were not the sole cause of the great depression, of course; nor was the depression the sole cause of our debt difficulties. But debt contributed to the lack of balance from which the depression came; and it was largely the weaknesses of our debt structure which made it possible for the business decline to go to such unprecedented lengths. . . . The Committee is convinced that our economic system would be far more healthy if debt financing were used less frequently, and that measures should be taken to reduce its extent."[24]

QUESTIONS

1. What evidence can you give that indicates that the Great Depression persisted not because of unwise New Deal policies but because of fundamental weakness in our economy?
2. Criticize some of the New Deal measures as recovery measures.
3. In what ways did conditions in the United States during the depression resemble those in Rome during and after the time of Julius Caesar?
4. What are the important requirements of economic health in a capitalist economy? To what extent did the pioneer community have these conditions?
5. "Big business must have profits; yet if profits are high, consumers cannot buy all the goods that are produced." Do you agree? Why or why not?
6. As a result of too much monopoly, according to Thurman Arnold, "hopeless confusion of both political and economic policies begins. Political government splits into irreconcilable pressure groups, each seeking a larger share in the diminishing national income, each destroying purchasing power in order to maintain artificial prices for itself, while increasing numbers of the unorganized and insecure compel the government to provide subsidies and relief out of the same diminishing income." Does this seem a fairly accurate picture of the operation of our economy before World War II?
7. Why should all prices be as flexible as possible in a capitalist society? Do debts and interest charges represent flexible prices?
8. In what respects is our money more unsound than it used to be?
9. How can you account for the vast expansion of debts of all kinds in recent years?
10. According to Harry Gideonse, "Swollen rates of profit are not the only thing that can overload an economic system. It can also be paralyzed by a swollen structure of genuine investment—not to speak of 'water.' An era that is too polite for bankruptcy is depriving itself of one of the great virtues of free enterprise, which provided for a ruthless elimination of those who made errors in anticipating the needs of the market or who did not adjust to new procedures with sufficient speed." Do you think more bankruptcy early in the depression would have been healthful?

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[23] Robert Doane, *The Anatomy of American Wealth,* Harper & Brothers, p. 21.

[24] Twentieth Century Fund, *Debts and Recovery,* pp. 253, 254.

Chapter 40.

The Decline of Capitalism

(*Continued*)

5. Need for greater equality in wealth and income

Inequalities of wealth and income should not be too great, for various reasons, if the capitalist system is to be strong and vigorous. In the first place, if competition is to be maintained, competitors should not be too unequally matched in financial resources. Traditional theory assumes that if businessmen manage their affairs badly, young men will rise from the ranks and displace them. So they may, and so they do to some extent; but it is clear that the greater the difference in wealth between the men in the saddle and those trying to mount, the fewer there will be who can join the cavalry.

In the second place, if too much income goes to the small group at the top who do not spend all their income for goods but save a large part of it, the masses of the people may not have enough income to buy the products they need, the products that industry must produce if there is to be full employment of labor.

This appears to be the actual situation in the United States. According to the Brookings Institution, the total savings in 1929 were at least 15 billions, nearly all saved by the rich and well-to-do; but of this, only 5 billions were invested in new capital. The other 10 billions —the "excess savings"—were "absorbed, dissipated, in bidding up the prices of outstanding securities." While the rich thus saved some 10 billions more than they could invest productively, the masses of the people—the lower 90 per cent—did not receive enough income to buy the full product of the economy. If the masses had received 5 billions more and the rich 5 billions less, the rich would still have been able to save more than they could invest, the masses would have been able to buy more, or save more, and the economy would have operated better.

If we are to regard inequality of income as a cause of the decline of capitalism, we must prove that the inequality is greater than it was in the years when capitalism worked satisfactorily, or we must show that other conditions have changed in such a way as to demand greater equality. As to the increase of inequality, no definite conclusion can be drawn, because there are no reliable figures that extend very far into the past, and even recent figures are subject to some error. Furthermore, it is not certain just what is meant by an increase in the inequality of wealth. There are more very rich men today than there were forty or fifty years ago, even in proportion to the population; while on the other hand there are some —southern sharecroppers, for instance—who are about as poor as the poorest people were a generation ago. In this sense, inequality may be said to have increased. On the other hand, statistical evidence shows that the income of the working class in Great Britain has risen more than that of the well-to-do classes; and there is some evidence that this may also be true in the United States. Although cautious in his statement, Taussig believed that this was probably true. Pareto found a decrease in inequality between 1897 and 1911, but Moulton, of the Brookings Institution, believes that there has been an increase in the concentration of wealth.

But economic conditions have apparently changed in such a way as to demand *less* inequality than there used to be. Since the rich do most of the saving, it was perhaps not altogether unfortunate that, when capital was still scarce, they received a large proportion of the total income. In recent years capital has been plentiful and savings have exceeded the amounts that the wealthy savers could invest profitably, while the masses of consumers have not had enough income to buy the commodities that existing capital is capable of producing. There is some reason to believe that mass production calls for mass consumption on a scale impossible with the present distribution of wealth. Isador Lubin expressed this idea very clearly in 1938:

> I think the outstanding thing that everybody will accept and agree to is that American industry is geared to large-scale production. Because of that fact, it must depend upon markets that can consume the output of mass-production methods. American industry cannot profitably maintain itself from the proceeds of sales to that portion of our families that has incomes of more than $5000. That segment of our population numbers but 794,000 families and constitutes but 2.7 per cent of the total families of the Nation. . . . Nor, indeed, can American industry maintain itself on the sales to the income group that receives $2500 or more. The families in this group comprise less than 13 per cent of all our families and in numbers constitute a population approximately equal to that of the State of New York.[1]

Lubin suggests that an increase of $2.25 a day in the income of those who receive $1250 a year or less would mean a rise of about $800,000,000 in expenditures for food; that an increase of $2.00 a day for the same class would raise expenditures for clothes about $416,000,000, for household furnishings and equipment $213,000,000, for automobiles and other forms of transportation $385,000,000, for recreation $234,000,000, for medical services $208,000,000; that an increase to $1500 a year would raise rent expenditures $613,000,000, and fuel, light, and refrigeration expenditures $213,000,000. The total of all these increases is less than the amount that the rich save and are unable to invest productively.

We need not rely entirely on statistical estimates here, for in wartime we can see what happens when small incomes rise. During World War II, the enhanced incomes of most farmers and laborers built up a demand which seemed adequate to absorb the full output of our industry. In spite of shipments of agricultural products to our allies, we had about normal peacetime supplies of some of these commodities, but we had to ration them to make them go round. Our experience during this war suggests that the surplus of some agricultural products which has plagued us in recent years would melt away if the masses of the people had incomes large enough to enable them to buy what they really need.

Not only does too great inequality of income prevent the capitalist system from working effectively, but it results in resentment on the part of the low-income groups which may blossom into radical legislation of various kinds, some of it harmful to the economy. When our productive capacity was low, many people had to be poor, because the current industrial output was not large enough to provide more than a few with luxuries or even comforts. Today our industrial plant could provide a fairly decent living for nearly all, and many people know it. So we have demands for old-age pensions, "Ham and eggs" plans, wage legislation, social insurance, better homes for the poor, socialized recreation facilities—scores of projects that the lower classes two or three generations ago never thought of. Some of these are demanded as a means of putting the capitalist machine into full operation again; some are needed and should have been provided long ago; but most of them call for public funds, and therefore heavier taxes, and some of them could hardly fail to make the operation of any capitalist system more difficult. If capitalism is to survive, it must provide a satisfactory living to the major portion of the people; and if it is to do this, it must be more democratic, in wealth and income, than it is now.

6. Need for individual rather than corporate enterprises

If capitalism is to be stable, business should be carried on largely by individual entrepreneurs. One reason for the decline of capitalism is undoubtedly the fact that so much of the nation's business has been taken over by large corporations. Some big business that is highly productive of goods, even if often unable to maintain full production, would be impossible, it is true, in the absence of corporate organization. No individual, except possibly a Ford or a Chrysler, could build such a concern as General Motors, General Electric, American Telephone and Telegraph, or any of our major railroad systems. Nevertheless, the corporate form is inconsistent with the assumptions of capitalism and has created many evils; we have already considered these evils in the chapter on business organization. In the present connection, however, the most important one lies in the fact that the corporate form has unquestionably increased the amount of monopoly through the increase in the size of business units and the decrease in their number, and through the facilities it affords for interlocking directorates, interlocking stock ownership, holding companies, patent-owning companies, and various other intercorporate devices. Through these various means the world of big business is bound up in intricate webs of control that make a mockery of the theories of competition and the ideal of rugged individualism. As President F. D. Roosevelt once said: "Private enterprise is ceasing to be free enterprise and is becoming a cluster of private collectivisms; masking itself as a system of free enterprise after the American model, it is in fact becoming a concealed cartel system after the European model."[2]

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[1] Temporary National Economic Committee, *Hearings*, Pt. I, p. 74.

Individualism is an essential element in a capitalist system, and the concept of rugged individualism dies a slow and lingering death. Ceaselessly the defenders of the status quo lift clarion voices in defense of this precious essence of American life, utterly oblivious of the fact that individualism has little place in the corporate world of today and dominates only the dwindling areas of farming, individual retailing, and the service industries, where it is no longer rugged but on the contrary genermally anemic. A hundred years ago the vast majority of the people were farmers and merchants, farmers greatly outnumbering all other classes; and farmers were individualistic in their economic life as well as in their philosophy. They did nearly everything for themselves, relied on their own efforts except in the few cases when they cooperated with their neighbors, and seldom even came into contact with the corporate segment of the economy. They were the stuff of which to build an individualistic capitalist society.

How this has changed! Even the farmer is caught in the web of corporate and organized business. His house may be built by a contractor, using organized labor and monopolized materials. His farm, which may be owned by the banker or an insurance company or plastered with a mortgage, he cultivates with complicated and expensive machinery made by the farm implement monopoly and propelled by gasoline or kerosene bought from an integrated corporate oil company. He sells his grain to the local elevator, which may be a unit in a corporate chain, and his livestock to one of the "Big Four" packers in a distant city. With the cash he receives for them and for his eggs and butterfat, he buys flour made by a giant milling corporation perhaps hundreds of miles away; he may buy his butter, cheese, and meat from the local A & P store, which is supplied by one of the big packing corporations in the nearest big city; he buys bread made by a big baking corporation, cereal foods from Battle Creek, fruit canned by a canning corporation, and Sunkist oranges sold by the great California Fruit Growers' Exchange. He still depends on his own well for water, but his light may come from the local light monopoly or from the Rural Electrification Administration. If he manages to save a little money, he may invest in land or a mortgage, or he may buy government or corporation bonds from some bond house. If he is a good Christian he may still go to the nearby church; as for recreation, he and his family are likely to find it largely at the movies or around the radio. The farmer is still individualistic in his philosophy, but his economic life is subject to the impact of corporate power at a hundred points, and he preserves his individualism only to a limited extent, and at heavy financial cost.

Today, however, less than 25 per cent of our people are farmers. The city man is the typical man, and even less than today's farmer is he an individualist, for he is likely to be an employee of some big corporation and a member of a labor union; if an individual businessman, he probably belongs to some powerful trade association. The businessman talks individualism, but he depends on organization to further his business interests. Corporate and organized business has largely destroyed the economic basis of the philosophy of rugged individualism.

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[2] Temporary National Economic Committee, *Monograph No. 21*, p. 259.

It would be practically impossible to eliminate all our corporations, but giant combinations must be broken up if we are to restore competitive capitalism. Discussing the problem of reviving capitalism, Henry C. Simons declares categorically: "As a main feature of the program, *there must be a complete 'new deal' with respect to the private corporation.* As many writers have pointed out, the corporation is simply running away with our economic (and political) system—by virtue merely of an absurd carelessness and extravagance on the part of the states in granting powers to these legal creatures."[3] As a practical program he offers various proposals, among them the following:

1. Federal instead of state charters for all corporations.
2. Prohibition of any corporation owning stock in another corporation (holding companies).
3. Limitations on the amount of property that may be owned by any corporation, to prevent monopoly.
4. Severe limitation on the number of kinds of securities that may be issued by any corporation.
5. Prohibition of interlocking directorates.

7. Need for physical expansion

An important characteristic of capitalism, as we have noted, is its expansiveness. It appears to have thrived best in a physically expanding economy, such as that of the United States—and to some extent much of the rest of the world—during the eighteenth and nineteenth centuries. During this period, millions of people were leaving the congested areas of Europe and Asia and the eastern centers of the United States, and were moving to free or cheap lands in Australia, New Zealand, and the Americas. This steady migration provided a market for the goods and capital made available by the manufacturing and financial sections of the world, a possible escape for laborers oppressed by their employers, a safety valve for stresses and strains that might have developed in a confined economy. Labor problems could scarcely become critical in the United States as long as laborers could take up free homesteads in the West; and, as we have seen, conditions in the frontier communities were almost ideal for the satisfactory functioning of capitalism. When people could "go west," they did not fight for opportunities at home; there were plenty of jobs, on the frontier if not elsewhere, so jobs and opportunities were not worth fighting over. Incidentally, some of the lower-middle-class ne'er-do-wells, the class that embraced Fascism in Europe and is scheming for it now in the United States, were to be found on the frontier a few generations ago, but they presented no serious social menace.

A considerable number of economists stress the disappearance of the frontier as a reason for the decline of capitalism. Frank Knight has thus explained not only the decline of capitalism but the drift away from individualism and political democracy:

> From the vantage point of the present, we can see that only a remarkable accidental and inherently temporary set of conditions made it possible, for a time, for such a "free" social system—private initiative in economic life and government through representative institutions—to seem to work, or seem to have the capacity of solving the problem of combining liberty with order. Democracy, such as it was, was possible only in so far as there were no vital political problems, no serious differences of opinion or conflicts of interest. . . .
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> The conditions under which free government was possible, meaning under which there were no serious political issues, were an incident of the "frontier." The geographical discoveries and technical inventions of the seventeenth and eighteenth centuries relieved social and economic pressures in the countries of Western Europe. With an essentially unlimited domain awaiting economic conquest, life ceased to be seriously competitive for individuals. A practically unbounded sphere of action and of self-aggrandizement was open for any and all with sufficient energy and ambition to count

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[3] Henry C. Simons, *A Positive Program for Laissez Faire,* Public Policy Pamphlet No. 15.

> seriously in social or political affairs. Such a world could be individualistic, and would naturally tend toward individualism—while the situation continued. It did so, and experienced a brief period of "freedom," a literal "withering away of the state." But with the filling up of the world and the passing of frontier conditions, requirements would revert to older norms of stability through discipline [4]

Imperialist expansion, which in the eighteenth and nineteenth centuries afforded an outlet for goods and capital, and to some extent for populations, and provided needed raw materials, is no longer the rosy business that it once was, not merely because there are no more colonies to be appropriated and developed and exploited, but because most colonies are not doing very well for the proprietor countries or for themselves. Most of them produce agricultural products and mineral raw materials—tea, cocoa, sugar, bananas, coffee, cotton, oranges, grapefruit, and palm oil, and tin, copper, petroleum, gold, and phosphates; and before the Second World War there was a serious world surplus and an excess of productive capacity in most of these products. While productive capacity rose and prices declined, the population of many colonies rose rapidly because of improvements in hygiene and medical services. The result is that many of the colonies, like producers of agricultural products and raw materials everywhere, have fallen into economic distress, and the returns from investments in these areas have declined. It is partly because of this that international restriction schemes were adopted to control the production of rubber, tea, sugar, tin, and copper, somewhat as Brazil resorted to burning coffee and as the United States restricted agricultural production under the AAA.

The policy of imperialism—the "colony business," in short—has not done well in recent years. Colonies have not served so well as outlets for capital, because the capital already invested was adequate to produce a greater output than could be sold at remunerative prices. With their people in economic distress, the colonies have not met expectations as markets for surplus goods. As sources of raw materials, however, they have done increasingly well, but here the proprietor countries have had no important advantage, since most such colonial products were sold to all buyers without restriction. Imperialism, one of the most characteristic aspects of capitalism, has, like capitalism itself, been in a state of general decadence.[5]

Somewhat analogous to the passing of the frontier as an explanation of the decline of capitalism is the decline in the rate of population increase. Some able economists, notably Hansen, believe that our rapid growth in numbers was a major factor in maintaining our rapid economic progress; that the restriction of immigration and the rapid decline in our birth rate have checked any increase in demand for such basic things as food, clothing, and shelter, whereas the productive capacity of our machines has risen at a rate unabated or increasing; and that as a result there is an inadequate demand for the goods that must be produced if we are to keep labor fully employed.

Lawrence Dennis holds much the same opinion: "Population growth has been taken for granted in the democracies as a constant factor. It has not been given much thought for the simple reason that it has never been a problem. On the contrary, it has been the solution of most of the problems of capitalism. But it was a solution which no one had ever had to think out or work out. It was an apparently automatic solution which Mother Nature provided for capitalist problems like depressions and public debts. It always made good the excesses of business optimism and public spending and borrowing for wars. It made capitalism and democracy virtually fool proof." Dennis points out that the debts incurred in the Revolutionary War, the War of 1812, and the Civil War were paid easily because our population and our wealth increased at a very rapid rate, and so reduced the relative debt burden.[6]

In what ways did the increase in population characteristic of the eighteenth and nineteenth centuries help to make the capitalist system operate successfully, according to this view? In the first place, a growing population gave businessmen confidence in the future. As Hansen has said: "This one central fact of growth and expansion dominated the whole of economic life. It minimized the risk of new ventures. If optimism had carried railroad building too far at the moment, if a city had temporarily overbuilt, the damage was short-lived. Expansion and growth soon made good the error. Business men could look far into the future with gigantic plants, with anticipatory capital outlays, investment plans which had no relation to the present, and which were based upon the expectation of growth and expansion."[7]

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[4] Frank Knight, in *University of Toronto Quarterly*, July, 1934, pp. 413–414.

[5] See H. D. Henderson, *Colonies and Raw Materials*, Pamphlets on World Affairs No. 7.

[6] Lawrence Dennis, *The Dynamics of War and Revolution*, pp. 88, 89.

Growth in population helped, not only by taking up the slack in case of overoptimism and so giving businessmen confidence, but also, according to Hansen, by creating a growing demand for goods. This theory should, however, be supplemented by the theory of monopolistic price fixing and restriction of production. The people now *want* all the goods that can be produced, and more, just as they would if the population were growing rapidly; and in a properly functioning competitive economy they would be able to buy them. If they cannot buy them it must be because their incomes are not high enough to enable them to buy at the prices fixed. This is the situation we should expect in an economy dominated largely by monopoly and monopolistic competition; but it would not be fundamentally different if the population were growing.[8]

Lawrence Dennis sees another function of population growth. He argues ingeniously and plausibly that capitalism works better when the population is growing because this creates "a perpetual scarcity of bare necessities, so necessary for a healthy capitalism or socialism." (Why he includes socialism we need not consider.) Only in a scarcity economy is it possible to keep labor docile and obedient. Dennis goes on to say:

> Those naïve neo-liberals who would solve the problems of the hour by stabilizing abundance have not learned that order is the first requisite of society, that order requires discipline, that discipline requires need and that need requires scarcity. For maintaining the necessary degree of scarcity a more humane way than unemployment or war would be perpetual pyramid building and peaceful squirrel-cage social activities imposed from above by a planning and coordinating will. In the absence of a dynamic scarcity, such activities are not self-generating among the masses. A dynamic society is one in which there is not enough food to allow the ruling classes to keep several millions unemployed on a relief roll. But unemployment and war, in lieu of large families, are obviously the course of least resistance."[9]

In yet another sense we find business enterprise "cabin'd, cribbed, confined, bound in to saucy doubts and fears." A capitalist society, based as it is on the profit motive and on the assumption of individual enterprise, must offer opportunities for individual enterprise. This it no longer does as it once did. Once there was free or cheap land, farm implements were inexpensive, and the farmer could at least expect a gradual rise in the value of his land, even though he earned only a modest income as a farmer. Today good land is expensive, implements are expensive, and the road to farm ownership, through tenancy and mortgaged ownership, is a rough road that not many are able to cover successfully; and at best the road leads only to the relatively poor and no longer hopeful life of a farmer. Individual retailing, in competition with the great retail chains and mail-order houses, offers a life of "double toil and trouble," with little prospect of profit. The small service businesses are overcrowded and on the whole unprofitable. Small banks, once the dream of local financial prepotence for ambitious men, are on the retreat before the advance of bigger banking units, and offer no bright future. The careers that were once typical of a hopeful individualist economy are no longer open, as a general rule. Only in the realm of corporate business is there much chance of rising; and in the big corporation the strong young man is merely a cog in a great machine, not the entrepreneur of capitalist economic theory.

8. Need for stability in international relations and freedom in international trade

The ideal conditions for the operation of a capitalist system include freedom and stability in international economic relations. This is highly important, because capitalism is strongly international in character, and international relationships with respect to trade, exchange, money, banking, war, and peace have powerful impacts on the economies of the different nations. From our study of foreign trade and tariffs we can see how the higher tariffs of Germany and England caused distress to the economies of Denmark and Japan; how dislocated exchanges or unwise monetary policies in any one country may have world-wide economic effects; how a bank failure in New York or Vienna may sound taps for an era of prosperity in every capitalist country. Depressions are seldom confined to one country, and the great depressions beginning in 1873 and 1929 affected almost the entire capitalist world. Capitalism is international in its very essence. Even our capitalist monopolies tend increasingly to be world-wide in scope.

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[7] Temporary National Economic Committee, *Hearings*, Pt. 9, p. 3504.

[8] See Harold G. Moulton, *Income and Economic Progress*, pp. 68–71.

[9] Lawrence Dennis, *The Dynamics of War and Revolution*, pp. 94, 95.

High tariffs have had a great deal to do with the world's troubles since the First World War. Although nearly every country had its tariff before the war, few of the tariffs were prohibitively high, and international trade was growing. During the war, which was largely a trade war, the belligerents on both sides brought trade under the strictest supervision, usually for the purpose of increasing imports and reducing exports, because most of the countries were in desperate need of many kinds of goods. After the war, the world needed a revival of international trade as never before, to regain former markets, rebuild shattered industries, restore severed economic relationships, feed and clothe the hungry, and heal the wounds of war.

The restoration of the physical plants, including those of the belligerents, was largely completed within a few years after the end of the war; but business lagged because economic connections on which the operations of farms and factories depended, connections broken during the war, could not be restored, partly because of rising tariffs. During Harding's administration we began to raise our tariff duties again; Germany and France, whose wartime industries had been developed on a vast scale and whose agriculture was accustomed to very high food prices, inaugurated a system of highly protective duties. Under the Bolshevik regime, Russia instituted a state monopoly of all foreign trade; a number of the small states created by the Versailles Treaty—Czechoslovakia, Poland, Hungary, Jugoslavia, and others even smaller—promptly availed themselves of the privilege of strangling themselves by raising their tariffs; and finally in 1931 Great Britain, for nearly a century the great free-trade nation of the world, turned to a protectionist policy. Added to the demoralization of trade restrictions, there was the crushing burden of war debts, the irritating problems of the debts owed to the United States and the reparations imposed on Germany. Europe was in a ferment much of the time after the First World War.

European war debts, owed largely to the United States, played a sinister part in promoting international ill will and reducing trade, largely because we did not adopt the liberal trade policy appropriate to our new status as a creditor nation. At the end of the First World War the United States found herself a creditor nation to the extent of more than 10 billion dollars owed her by other nations; the annual interest payments amounted to several hundred millions a year. If we had adopted a free-trade policy, as Great Britain had done earlier under similar circumstances, or even a liberal policy, some of the interest payments might have been made—in goods, of course, since international trade in the long run must be largely in goods—with resulting stimulus to trade and to international good will. Or if we had canceled and forgotten the debts and had been willing to reduce our tariff enough to permit trade to revive, we might have helped to bring about a revival of world trade and prosperity. Ignoring both of these alternatives, however, and following the stupidest possible policy, our country insisted that the debts be paid, but refused to accept the goods in which payment had to be made.

It should not be assumed that high tariffs have been the basic cause of the collapse of capitalism, or that their relation to this breakdown represents a simple case of cause and effect. Tariffs have played a fairly important part without doubt, but they were themselves in turn, to some extent, the results of the stagnation of business in the various countries.

Here, as often in economics, we have a case of the interaction of economic forces, with business paralysis leading the people to demand more tariff toddy, which makes them feel worse and demand still more.

If international economic relations are to be free and stable, there must be a stable and satisfactory means of making international payments. International exchange is a system of delicate balance which can be thrown out of kilter by monetary tinkering on the part of any of the important countries. As we saw in the chapter on international trade and exchange, for more than a century gold or silver, or both, served as currencies throughout the world for the settlement of international obligations. From the 'seventies to the outbreak of the First World War gold alone was used almost everywhere; it was the means of making international payments, of keeping prices in the different countries at such relative levels that trade could be carried on and payments could be made. During World War I, however, this situation changed. Many countries discarded gold, and in the postwar years Germany and Russia went through a devastating inflation. For a while it appeared, nevertheless, that the world might get back to the gold standard. Britain returned to it in 1925, but maintaining it proved a serious handicap to exporters, and she was obliged to suspend it in 1931. Even before this several countries had gone off the gold standard, and when Britain did so, her action had world-wide influence, for she was the world's largest free market for goods, and London was one of the two greatest financial centers. Within a few days the Scandinavian countries followed her lead, and two or three years later almost every important country in the world had abandoned the gold standard actually, if not by definite legislation. During this period and for some years afterward, various countries, including the United States, experimented with their currencies with the purpose of raising prices or stimulating exports, but with little consideration of the effects on the rest of the world.

Abandonment of the international gold standard and disruption of the exchange were not simply causes of the decline of capitalism. They were rather merely aspects of it, for they themselves were the result of other factors, particularly the world-wide decline in prices, the paralysis of industry, and heavy indebtedness everywhere. As G. D. H. Cole suggests, the abandonment of the gold standard was inevitable and necessary under the conditions that existed in 1931. It is unfortunate, however, that the shift was not made through some sort of international agreement, for this might have avoided much of the disruption of trade and exchange that resulted from the conflicting monetary policies pursued by the nations acting separately. International economic relationships can never be stable or satisfactory until monetary policies are determined by international agreement.

International relations must be stable in yet another sense if capitalism is to be maintained in full vigor. There must be peace. Capitalism is a system of delicate balance which may be upset by war. Although it survived such limited wars as our Civil War and the Franco-Prussian War, there is no doubt that the First World War gravely weakened it throughout the world, through dislocation of trade, markets, and currencies, and through the unmanageable debts created by the war. Or, as Sir Arthur Salter suggests, perhaps the war "reduced the world's resistance to older weaknesses and hastened their fatal consequences." Russian communism was the first offspring of that war; Mussolini and Hitler emerged from the disorder and distress of later years; and there is reason to fear that capitalism has been further weakened by the Second World War. Machine technology has tied the world into such a tight economic knot that the wars of the future are likely to be "world" wars like the last two, and their consequences will be grave.

Already there is considerable evidence that many countries are even now moving away from capitalism toward socialism or Fascism. The middle classes in some of the occupied countries of Europe, the classes which have in the past been the bulwark of capitalism, were ruined by the German occupation. Wealth was destroyed, the delicate connections of capitalist business were broken, and many people are hungry, discontented, and thoroughly disillusioned. They know that many of their own business leaders and aristocrats were sympathetic toward German Fascism; and they are unlikely to want to reestablish the sort of capitalist system under which they were so betrayed. In short, many of the European peoples are demanding moderate socialism and in some cases communism; and to prevent this, business oligarchs, with army support, are likely to try to impose Fascist regimes again, and they may succeed. The outlook for democratic capitalism in Europe, as in many other parts of the world, is not bright.

9. Need for minimum intervention by the government

One cause of the decline of capitalism has been unwise government policies; for if capitalism is to operate successfully, the government should not intervene in such a way as to discourage individual enterprise or interfere with necessary economic adjustments.

It is not true, as some conservatives appear to believe, that all government intervention tends to undermine capitalism. Public education, once opposed by many of the rich and well-to-do on the ground that it would impose too heavy a burden on income and property, has contributed a little, if not very much, to the development of such public intelligence as is necessary to the operation of a capitalist democracy, although in some communities the cost of the public school system has raised taxes to a level that is extremely burdensome on property owners. Pure food laws and similar legislation to protect consumers from deleterious and inferior products do not discourage business in general, but merely raise the standards of competition. More of such legislation, if wisely drawn and administered—for example, government-enforced standardization and grading of such products as milk, ice cream, canned goods, some kinds of cloth, and other products with which this can be done accurately—would make the capitalist system work better and would raise the standard of living greatly. This is also true of labor legislation establishing standards of safety, sanitation, and health in factories, and governing workmen's compensation, child labor, women's labor, and many other conditions in industry. Such laws apply equally to all employers in a given industry; and therefore, unless they are more drastic than they have been in the past in the United States, they do not greatly discourage enterprise, but only raise the plane of business competition. Regulation of utilities does not reduce the efficiency of capitalism but is an essential government function where the utilities are privately owned. Suppression of monopoly by every means possible is essential if the competitive conditions required in a capitalist society are to be maintained. It is also possible that if all large corporations were subject to more careful supervision our economic system would work better. Government encouragement of terracing and soil conservation is likewise beneficial, for no economic system can operate with great success if its farmers work on ruined land. The example of Sweden, whose government assumes more functions than ours does and where capitalism works better than in this country, proves that a government can exercise many functions and yet preserve a successful capitalism if it is wise in choosing the forms of intervention.

As for public relief for the poor and unfortunate, it is difficult to draw a simple conclusion. The Webbs insist that all the various means by which the government has protected the poor from the "whip of starvation" have encouraged idleness and undermined capitalism. "It will be said here, and said very cogently, that democracy may say what it pleases and vote how it pleases, but that any system under which a large section of the population can obtain maintenance for themselves and their families without being required to accept work at such jobs and at such wages as are actually obtainable then and there, must lead to national bankruptcy; and that if it be an objection to the capitalist system that it enables thousands of the population to live in idleness, a system which enables millions to live in idleness is in that respect an intolerable aggravation of the evil."[10] This was written, let it be noted, not by a hard-boiled businessman or a conservative economist, but by socialists, in 1923.

John Strachey, another socialist, is quite as unequivocal in his opinion that capitalism demands the abolition of most forms of "social services" for the poor, and the destruction of labor unions or their reduction to impotence in order to restore a free competitive labor market. If we are to return to the "free market" of competitive capitalism, he suggests as necessary the "reversal of the whole tendency toward the establishment of social services, . . . for social services and static wage rates are progressively 'freezing' one of the most important variables of the market [wages] into a disastrous immobility."[11]

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[10] Sidney and Beatrice Webb, *The Decay of Capitalist Civilization*, p. 174.

This is harsh but undoubtedly logical, for it reverts to the conditions which obtained when capitalism was in its vigorous youth. As a practical program, however, it can be of little pertinence for the world of today. As long as laborers and people with small incomes have votes they will vote for generous relief provisions and social services, as will also a considerable proportion of the middle and upper classes; and even if a dictatorship in this country took the votes from the lower classes, it would doubtless have to provide a minimum of subsistence and security for the poor. The Fascist states, which were established partly for the purpose of destroying labor unions, were obliged to do this. In the present world, denial of relief and help to the really needy might well result in the creation of a rebellious class who would present a threat to political stability.

It is often asserted that the New Deal's generous relief policy caused many people to lose stamina and character, and the industry, thrift, self-reliance, and hardihood necessary to the operation of a capitalist system.

It is doubtful, however, if the character of the people has changed very much, for such changes as we see are in large measure due to changes in economic conditions. Some people are more finicky than they once were about the kind of work they will do; they are less willing to skimp and save and suffer hardships and deprivation to keep off the charity rolls, and more willing to accept or demand public assistance; but this is inevitable under present-day conditions. If during a depression and a period of widespread unemployment some of the unemployed are unwilling to do just any heavy or disagreeable work they can find, this does not necessarily signify a decline in people's industriousness, for today more people are educated and trained for specialized types of work, and turning to the lower grades of work might represent a great sacrifice.

If there appears to be a decline in the willingness of poor people to prepare for a rainy day, we must remember that there are more enticing things to buy today, and more skilled advertisers and salesmen trying to wean the weak-willed away from the ideal of thrift. Doubtless automobiles have done their part here, in the first place because to many Americans they are the greatest of all goods, the absolute essential of civilized existence, but at the same time too expensive for most of those who buy them; and in the second place, because they have increased the mobility of the people and enabled them to see, and therefore want, luxuries that they once knew little about. The movies, with their scenes laid in wealthy homes and their display of period furniture, gorgeous gowns, regal parties, and expensively arrayed forms of wickedness, have likewise made it hard for some people to save, have tended to increase their "propensity to consume." Furthermore, the safe investment of savings is more difficult than it once was. At one time the farmer, in a predominantly rural economy, usually put his savings into land or a mortgage on land, generally a safe and profitable investment; but today, in our more complicated economy, the problem of investing savings wisely is beyond the understanding of any but the wisest and shrewdest men.

The common complaint that the people have grown "soft," that they have lost the hardihood of earlier years, need not detain us long. Of course people are not willing to live as poorly as they once did in order to stay off the relief rolls. It was no serious hardship to live meagerly when almost everyone did so. The pioneers did not complain because they lived in sod houses, for everyone else did; they did not feel it a great hardship to go barefoot when most of the people in the neighborhood went barefoot; but it would be a great hardship, in our present era of relative plenty, to live in a sod house and go without shoes. Not only would such hardship seem worse now, it would seem less necessary. Rather than submit to it, some people call upon the government for aid, and they cannot be blamed much for doing so. People today are doubtless about the same as they have always been, but conditions are different.

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[11] John Strachey, *The Coming Struggle for Power*, p. 141.

Somewhat the same thing holds true of the alleged decline in self-reliance. People are as anxious to stand on their own feet as they ever were; but it is more difficult than it once was, at least in a period of depression and heavy unemployment. In the simple economy of a few decades ago, when a large proportion of the people lived on farms and in small towns, it was easier for an unemployed man to find some sort of work to tide him over, chores and odd jobs which brought in enough to live on. In the complicated, integrated economy of today, with its hundreds of thousands of laborers in the great urban centers, obviously this is not so easy. There are not odd jobs for so many laborers when a business recession strikes; hence some are obliged to seek government relief after their own meager savings are exhausted.

There is, however, a growing "softness" in one sense: people have more sensitive social consciences than they once had, and are less indifferent to the hardships of the unfortunate and unsuccessful. There has always been a small proportion of people who were able to eke out only a meager or miserable living by picking up bits of work here and there or doing the meanest, dirtiest, and worst-paid jobs, worried and insecure, and often too hopeless even to worry. They could be seen in the poor sections of every large town or city. The more fortunate classes knew little about them, and were little concerned. Today their plight has been made public by social workers and journalists; and the more fortunate classes, themselves more comfortable than formerly, more conscious of the fact that poverty is due mainly to social causes rather than to individual shiftlessness, and more alive to the social dangers of having any such submerged class, have extended relief and help in various ways. This help has enabled some unfortunates to get onto their feet and rise up out of poverty, but it has pauperized those who find it not so bad to let a relief card rather than hard work support them. Moreover, this help increases the taxes paid by those who can and do work, and tends to weaken the incentive for work and thrift on the part of others. There is no doubt that the relief policy of the New Dealers has pauperized some of the poorest people, often because there was no careful investigation of cases. In some cases self-supporting laborers and farmers have had to live more meagerly than those on relief, and certainly this does not encourage the industry and thrift on which capitalism depends.

To return to the problem of government intervention, even outright government ownership in some economic fields may help to preserve capitalism. Government ownership of forests, parks, coal and oil reserves, and other natural resources restricts the field of private enterprise, but it makes the capitalist system operate more satisfactorily because it reduces the amount of monopoly and conserves the resources needed in our economy.

Yet government intervention does in some cases discourage private enterprise. Taxes have recently been raised to a level where some of them are almost confiscatory. Taxes on some of the railroads are so high as to confiscate most or all of the earnings; in fact, some railroads have become mere tax-gathering agencies for the government, for they pay no dividends to their stockholders, yet in some localities, pay as much as half the local taxes. A considerable number of corporations pay more in taxes than in dividends, which means that the government takes more than half the net earnings. Property taxes in some towns and cities absorb most, and in some cases all, the net rent. Income and inheritance taxes were probably not heavy enough before the war to discourage business enterprise much, except in the investment of "venture capital," in new and risky enterprises. To be attractive, such enterprises must offer a chance of high profits to balance the possibility of heavy losses; but when the government confiscates much of such profits as are made, such ventures become unattractive to businessmen. If the fantastic costs of the Second World War are ever to be paid, many taxes will be so heavy for years to come as to be definitely discouraging to business.

In many cases, government intervention has had the effect of interfering with necessary economic adjustments. During the Great Depression, for instance, when many people were staggering under debts which they could scarcely hope ever to pay and the health of our economy called for the liquidation of many of these debts, the government embarked upon a policy of further lending in order to bolster up a credit structure which was fundamentally unsound. Similarly, one of the obstacles to the resumption of private business early in the depression was the too-high wages paid in some lines of business; yet part of the New Deal program called for wages to be bolstered up through minimum wage and maximum hour laws and encouragement of labor organization, on the quite untenable theory that high wages would increase purchasing power and help to revive business activity. Without a doubt the New Deal's wage policy had something to do with the persistence of the depression.

The Agricultural Adjustment Administration was set up to increase the prices of farm products. There was a surplus of farm products and prices were low—a market sign meaning too many farmers. Had the government allowed prices to work out their effect fully, some farmers, mainly those on poor land, would have been driven out of production, and the supply of farm products would have been adjusted to the demand at higher prices, with the farmers who could continue in business producing enough to enjoy lowest average costs. At any rate, this is the appropriate theoretical analysis of the situation, doubtless to some extent valid. Through the AAA restrictions on crop acreages, however, the government jacked prices up high enough to enable most farmers to continue production, but at generally high costs, because none were allowed to expand their output to the point of lowest average total unit costs. So we had more farmers than were needed, and they were producing at less than full capacity and at high costs. This was an unstable situation which could be maintained only by government compulsion or by "bribing" the farmers to restrict production, or by both. It could not correct itself as long as the government did not permit the laws of market price to work freely. This is not to be construed as a general condemnation of the AAA policy; the point is that government intervention interfered with needed adjustments in our economy. Under the impetus of war demands, this situation was reversed, but it is likely to recur.

Under pressure from special interests, the government itself has done much to foster monopoly and so to weaken our capitalist economy. The federal government passes tariff laws which increase the amount of monopoly, and the state governments set up interstate trade barriers which have the same effect. The federal government grants the patents which not only are themselves monopolies but bolster up industrial monopoly. The government creates corporations, which similarly increase the amount of monopoly and weaken the capitalist order. A great many of the laws enacted in recent years by federal, state, and local governments have tended more or less to hamstring competition, promote monopoly, and freeze prices—laws regulating milk distribution, which may "constitute a public underwriting of a private scheme of price and production control"; laws to regulate trucking, which often have the effect of pegging rates at a certain level; laws authorizing shipping companies, exporters, marine insurance companies, fishermen, security brokers, and various other classes of businessmen to "cooperate" in fixing prices which will yield a "reasonable profit." The Miller-Tydings Act of 1937, legalizing resale price maintenance, was designed to prevent retailers from cutting prices below the level set by the manufacturers. The National Industrial Recovery Act of 1933, which was designed to promote recovery by insuring producers a "fair price" through the "codes" set up by the various trade associations, proved in actual practice to be an instrument for suppressing competition and promoting monopoly. Fortunately the Supreme Court declared the law unconstitutional; but many of the codes were maintained afterward, with the general result of increasing the amount of monopoly in an economic system which was already too much charged with it. The NRA did not merely promote monopoly, it illustrated the broad trend away from competitive capitalism. The businessmen who backed the NRA and drew up the codes did not want to destroy capitalism, but they failed to realize that the suppression of competition inevitably leads to the decline of capitalism.

Seeing that business was under a considerable measure of monopoly control, the New Dealers decided that agriculture could never prosper as an almost purely competitive enterprise, so they proceeded to make a sort of government-controlled monopoly of it under the AAA, reducing production and raising prices just as businessmen did in urban industries. There was much criticism of this policy of enforced scarcity, but it was merely giving the gander some of the sauce that the goose had long enjoyed. It made the scarcity and high prices more general. Many of the New Deal measures were designed, in one way or another, to maintain scarcity.

And so the government itself proves to be perhaps the most important promoter of monopoly and of the scarcity that accompanies monopoly. It is not consistent in this, however, for while promoting monopoly in a great many ways, it has been engaged in a vigorous campaign of trust-busting; but there is some reason to believe that monopoly promotion is a more fundamental and persistent trend than trust-busting. If an administration that is more favorable to business interests should come to power, it would probably do more to protect businessmen from competition, while mollifying its campaign against the monopolies.[12]

10. Need for popular desire to retain capitalism

This brings us to the final essential condition for the maintenance of capitalism: the people must really *want* to retain it, must understand the forces which are undermining it, and must set themselves resolutely to the task of maintaining it. These things they have not done well; on the contrary, there is increasing evidence that they do not wish to preserve capitalism, or do not know how to do it. They vote for high tariffs, for laws that stifle competition, for relief for farmers and debtors and rich industrialists and poor people and for any class that can organize as a strong political pressure group. More and more the government becomes the dispenser of handouts; and it is often the very people who vote for handouts who complain meanwhile of the growth of government bureaucracy and the rising burden of taxation. In voting for such policies the people do not consciously and deliberately wish to destroy capitalism. The rich manufacturers who demand tariff protection and price resale maintenance, the industrial producers who unite in monopolistic combinations, the laborers who combine in monopolistic labor unions, the old folk and unemployed who demand generous pensions and relief payments—these people do not wish to undermine the capitalist system; but the total effect of their demands and actions is to do exactly that.

Is there then no way of reviving and maintaining capitalism, the system under which we once prospered? Are there no measures that we might take which would "purge it to a sound and pristine health"? To many these questions will seem silly and fatuous, particularly in view of the roaring prosperity which accompanied World War II; but unless the nature of capitalism is unaccountably transformed, in the not too distant future we shall plunge into another depression which, because of the vast accumulation of debts and other war-begotten ills, is likely to be worse than the one from which the war temporarily rescued us. We may run along for some years, possibly even for decades; but capitalism is in its old age, and its rejuvenation depends on whether some of its fundamentals vices can be cured.

The restoration of a vigorous capitalism demands, in general, the restoration of the conditions which prevailed when capitalism functioned satisfactorily. Although these have been outlined in the preceding pages, their recapitulation will show how vastly difficult our task is. How can a government which is largely controlled by monopolists move to break up monopoly; how can it take from the bankers the power to create and destroy money in the face of the opposition of the banks; how can it proceed to wipe out or drastically reduce the debts which, in the form of bonds and mortgages, are the support of our vast total of life insurance, trust estates, savings banks, endowed universities, philanthropic foundations, and private investments? How, against the opposition of the most influential members of our society, can the government hope to push very far in the direction of economic equality? Largely dominated by great corporations in business and politics, how can we hope to break up even the worst of our corporate octopuses? With our geographical frontier gone, our population nearly stationary, and the frontier of invention and innovation fenced in by monopoly-controlled patents, how shall we resume economic expansion; with foreign policies in all capitalist countries largely dominated by powerful, protected, and largely monopolized interests, some of them tightly organized as international cartels, how can freedom and stability in international relations be restored; with every organized economic class reaching into the national jackpot, every class indifferent to the effects of its demands on the total economy, how can government intervention be held within reasonable limits? The vast majority of Americans want to retain capitalism; but with a hundred forms of entertainment inviting them to relax, will they devote the necessary time and energy to the study of capitalism and the means of maintaining it?

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[12] On the relation of the government to monopoly, see Temporary National Economic Committee, *Monograph No. 21*, pp. 259–279.

Looking at these questions coolly and without emotion, we can hardly feel optimistic, and we may well feel almost hopeless. The Scandinavian countries have proved that it is possible to maintain a successful and satisfactory capitalism; but conditions in the United States are very different from what they are in those countries. We have a more complicated economy, a more powerful corporate group that is determined to retain its power, and a people who are far less interested in public affairs, and as a result less intelligent.

A number of economists have mapped the procedure necessary to revive capitalism and its "free market"; their plans run generally along the lines followed in the present analysis, but they seldom show much optimism.[13] John Strachey ridicules their efforts eloquently if perhaps with too much pessimism:

> It is sad, though it is explicable, and indeed inevitable, that so much talent should be lavished by these able economists on a cause lost these thirty years. Let us erase from our minds for a moment all that has been said of the practical impossibility of restoring the market [the free market of capitalism]. And let us envisage the psychological task that would be involved. Let us consider the dying faiths which would have to be revived, the worn-out political watchwords recoined, the strange outdated weapons of social struggle refurbished, if the free trader economists could by some stroke of magic have their way. In order that the free market might flourish again, the whole system of ideas which reached perhaps its highest point in nineteenth-century Britain, and its very apogee in nineteenth-century Lancashire, would have to be raised from the dead. Out of the Lancashire of today, out of the now silent mills, out of the empty weaving sheds, the very machinery of which has been sold off to Allahabad or to Shanghai, would have to emerge, as from the grave, a new generation, with the unquestioning faith of their grandfathers in the principles of democracy, the British Parliamentary system, the Protestant faith, and a total absorption in self-enrichment as a religious duty. Even the ghosts of these ideas do not walk. They are laid forever. For the epoch of human history and the material conditions which alone gave them life have passed away down the irreversible stream of time. Only the least historically minded men on earth, only English economists, could dream of their resurrection.[14]

Now that the United Nations have defeated the wicked tyrants, Hitler, Mussolini, and Hirohito, many people have a naive notion that the Germans, Italians, and Japanese will follow the peaceful ways of capitalist democracy and all will be well. Perhaps it may be so; but let us remember that Hitler and Mussolini arose out of the distress and frustration of a disordered capitalism that could not be made to provide jobs and security for the people. Japan of course never had much democracy, political or economic. It is difficult to see how the Germans and Italians, who for years were forbidden to think about economic and political questions, can solve the problems that formerly, when their minds were still unimpaired, were beyond their powers. To the Germans, capitalism is likely to mean the kind of monopoly capitalism that they had before Hitler's regime, controlled by powerful industrialists some of whom helped to put Hitler in power. Would they want that kind of an economy again?

The truth is that many of the peoples of Europe are moving toward socialism or communism, and probably the only way to stop that drift is to impose Fascism upon them again. For many of them, democratic capitalism is not one of the possibilities. But this will appear more clearly in the following chapters.

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[13] See F. A. Hayek, *Prices and Production;* André Siegfried, *England's Crisis;* Lawrence Dennis, *Is Capitalism Doomed?* Henry C. Simons, *A Positive Program for Laissez Faire,* Public Policy Pamphlet No. 15. Simons' brilliantly written pamphlet is probably the best brief discussion of the problem of reviving capitalism and should be read by all who are interested in America's economic future.

[14] John Strachey, *The Coming Struggle for Power,* pp. 150–151. By permission of Crown Publishers.

QUESTIONS

1. In what ways has inequality of income contributed to the decline of capitalism? What measures would you suggest to reduce this inequality? Does our experience in World War II throw any light on the significance of this factor in our economic decline?
2. "We don't need to prove that there is *greater* inequality now. We need only to say that we must have *less* inequality in the modern economy, to make it work effectively." Explain clearly.
3. In what ways has the spread of the corporate form weakened the capitalist system? Why is capitalism essentially an individualist economy? What philosophical virtue can you see in an individualist society?
4. The corporation appears to be necessary to efficient production, but it is not consistent with the assumptions of capitalism. What shall we do about this?
5. "It appeals delightfully to my sense of humor to hear monopolists sound off stentoriously about 'individual initiative' and 'free American enterprise,'" Secretary Ickes once said. What is humorous about it? Where do you find individual initiative and free enterprise in our economy?
6. According to Harry Gideonse, "It is probable that the modern large corporation, about whose imperfect competition we hear so much, earns lower profits and maintains more flexible prices than the old-fashioned local grist mill, iron foundry, or general store." Is it possible, nevertheless, that the monopoly and monopolistic competition characteristic of our modern economy are of such a nature as to weaken the economy more than the smaller, earlier monopolies?
7. If the government gave the unemployed free farms, would our economy work better? What would happen to the price of farm products? Were there not enough farmers before the war? Would free land be as helpful as it was earlier? Why or why not?
8. Frank Knight describes the pioneer situation as a "withering away of the state." What functions did the state perform in Dodge City and other early cattle towns?
9. In appraising the significance of the decline in the rate of population increase, why must we also consider the role of monopoly?
10. Was imperialism one of the reasons why the capitalist system worked as well as it did in the eighteenth and nineteenth centuries? Was it not one cause of the Second World War, and therefore of the decline of capitalism? Why the change in its influence?
11. World War II was both the cause and the effect of the decline of capitalism. Explain. Could this be said of tariffs and of currency changes in the various countries?
12. Which of the following tend to make the capitalist system operate less efficiently:
    - The AAA
    - Minimum wage laws
    - Encouragement of labor unions
    - Pure food laws
    - Sales taxes in ordinary times
    - Progressive income taxes
    - Tariffs
    - Better regulation of corporation practices
    - Really efficient and intelligent regulation of monopoly prices
    - Abolition of closed labor unions
    - Hundred per cent reserve banking
    - Government ownership of natural resources

13. The Constitution of the United States was based on the theory that the least government is the best government. Ever since its adoption, the government has been intervening more and more. Why this violation of the spirit of the Constitution?
14. In what ways has the government fostered monopoly? How can you explain government trust-busting at the same time that it is fostering monopoly?

Part VII

THE OTHER ISMS

Chapter 41.

Socialism

Ours is the liberating movement of the ages. It is consecrated to the cause of the oppressed. It bears the scars of a thousand defeats, but it grows stronger, and braver, and more invincible through them all, and it will never lay down the weapons of peace-loving crusade, never cease its holy war until its triumph is complete and sets the whole world free.

—*Eugene Debs, socialist leader*

On practically every point in his analysis, and in every one of his specific proposals, the socialist manages to be wrong, to mistake symptoms for causes and to apply his remedies at the wrong place, making it morally certain that his remedies would produce evils worse than those they were intended to cure.

—*T. N. Carver,* Essays in Social Justice

Reasons for studying the isms

The study of the isms is necessary for several reasons. In the first place, we are borrowing ideas and policies from them all the time. Thus we have heard much about "planning" in recent years—five- or ten-year plans of various sorts, for instance, an idea probably borrowed from the Russian "plans." It is often said that socialist proposals are usually adopted by the conservative parties about fifty years after they are first made by the socialists. In the second place, we were allied with communist Russia against the Fascist powers in World War II, and we should know something of the systems with and against which we were fighting. If the politicians and people of England, or for that matter of our own country, had understood the real nature of Hitler's National Socialism, they could have snuffed out the Fascist threat before it became serious, thus saving the world from the agony of the war. Ignorance in such matters is extremely expensive, if not suicidal. In the third place, unless capitalism shows more vitality in the future than it has in recent years, we shall be obliged to move in the general direction of "collectivism"—socialism, communism, or Fascism—and since the future of our civilization may depend on the course we take, it will be well to choose it with our eyes open.

A study of these various systems, not only by students but by all the people, would enable us to preserve our democratic institutions; but few people devote much time to such matters, and few are able to think about them with clear and judicious minds. When socialism or communism or Fascism is mentioned, most people, although largely ignorant of the meaning of the terms, proceed to turn off their brains and stage an imitation of an apoplectic fit; and, on the other hand, many advocates of socialism, communism, and Fascism preach their doctrines with all the zeal of a revivalist at a Holy-Roller camp meeting. The truth is that many people take their economic religions more seriously than their church doctrines, perhaps because they feel more confidence in their earthly estates than in any that may be awaiting them in heaven. As Harold Laski says: "Let us realize that in any society, the ultimate principles upon which a government rests are to those who accept them in the nature of a religious faith; and their antithesis also is a religious faith to its upholders. . . . There is no phase in the history of religious ideas which cannot be paralleled in the history of social doctrines. Each has its zealots, its priests, its poets, its soldiers; each strives for conquest, and will die rather than surrender."[1]

Classification of attitudes

In their attitude toward different economic systems and toward economic change in general, people may be classified in various ways. Thus they are often classified as reactionaries, conservatives, liberals, progressives, or radicals. *Reactionaries* want to go back to some earlier situation which they regard as better than the present; they are particularly interested in eliminating most of the government's interference with business. *Conservatives* do not necessarily want to go back, but they are opposed to further changes. Thus they may not disapprove of the prevailing government intervention but will oppose any further extension of it. (Someone has defined a conservative as a creature who dreads the effect of a new idea on the feathers in his nest.) *Liberals*, as this term is often used in America, have no strong bias or preconceptions either way, but are willing to approach questions with an open mind.[2] *Progressives* advocate further changes in the general direction of more government action. *Radicals* want changes to be both extensive and rapid, although in another sense they may be regarded as those who want to go to the *roots* of problems, for radical is derived from *radix*, the Latin word for root.

These various attitudes appear in other fields than economics. In religion, for instance, there are the conservative Catholic and Lutheran churches, the liberal Congregational church, and the radical Unitarian church. In their attitude toward the family, people may be reactionary, wishing to go back to an earlier family institution in which there is no divorce and in which the husband and father is the dominating authority; conservative, not opposed to the existing amount of freedom in the family but against any increase in freedom; liberal, willing to consider any proposals for change in either direction; or radical, favorable to easier divorce and greater democracy in the family. Strangely enough, few people are consistently conservative, liberal, or radical in their attitude toward these various problems. If they were consistent, all Catholics would be economic conservatives or reactionaries, and all Unitarians would be economic radicals and perhaps inclined a little toward free love. The truth is that many Catholics are liberal in their economic views, and many Unitarians are conservative. People are queer bundles of inconsistencies—intellectual "two-headed calves," as someone once described them.

In the economic field, one of the most fundamental questions relates to the extent of government intervention. On this question we run the gamut from the anarchists, who want no government whatever, to the communists, who favor government control of both production and consumption. Between these extremes are the conservatives, who are opposed to any extension of government activity, and the socialists, who favor government ownership and operation of important productive capital, but not government control of consumption. Although capitalism, as it has usually operated in the past, implies a minimum of government interference, for more than a century there has been a steady increase in the amount of government activity, both in the regulation of private business and in direct government production. At present there is much left of the old laissez-faire capitalism, but our economic system has some definitely socialistic elements, such as the municipal ownership and operation of public utilities, and some elements that even approach communism, as in our public school system. We commonly refer to conservatives as standing to the "right," and to radicals as being on the "left."

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[1] Harold Laski, *Democracy in Crisis*, p. 161.

[2] In England the term has a somewhat different meaning, for there it indicates belief in the adequacy of economic laws, and a general hostility to most government action.

No system good or bad in all respects

In appraising the various isms, the student should avoid the common assumption that any particular economic system is definitely and entirely good or bad, or even definitely better than another. Every system has its merits and its vices when viewed in relation to economic and other conditions, race, traditions, and particular ends and ideals; and no system is necessarily good for all individuals and peoples in all possible circumstances. The principle of relativity applies here as in most economic generalizations. If our ideal is the production of wealth, capitalism has proved a very good system; but if our ideal is contentment, it might not rate so high, and in waging war it seems quite inferior to Fascism. Partly because of natural qualities and partly because of long-ingrained tradition, some races appear better adapted to capitalism than others. Most of the peoples of western Europe apparently have the qualities needed to make it function successfully and in the past have been satisfied with it. On the other hand, many of the peoples of Asia, Africa, and parts of the Americas are apparently too indolent, too easygoing, too impractical—or perhaps too wise—to achieve great success under capitalism.

Varieties of socialism

Socialism has taken many forms, for although socialists agree in advocating increased government intervention in economic activity, they differ as to its extent, as to the rate at which the government should take over private business, as to the process by which it should assume control of economic functions, and as to the general spirit in which it should carry on its functions. Some socialists call for government ownership and operation of all enterprises, including such small businesses as retailing and farming, whereas others favor private operation of small enterprises. Some insist on the immediate adoption of the socialist program; others favor a more gradual procedure, or assume that socialism is inevitable and that therefore any great agitation or propaganda is unnecessary. Some believe that it can be achieved by democratic processes, by persuading people to vote for it, others—Karl Marx was among them—assume that this is impossible and that, except perhaps in England and the United States, the socialist state can be achieved only by violent revolution and the forcible expropriation of property owners. A great many advocate socialism in a spirit of sympathy for the classes that have fared ill under capitalism; but others, for instance the Marxians, although moved to some extent by sympathy for the underprivileged, are also moved by a fierce rage at what they call the "exploiting capitalist class" and by a determination to deal harshly with it when the revolution comes.

Not only do socialists thus differ in their views, but some of them have mingled elements of anarchism, communism, Fascism, religion, and philosophy with their socialism. Many of the utopian socialists of the period following the French Revolution and of the revolutionary years after 1830 can perhaps best be classed as communists rather than socialists, and a few showed traces of anarchy in their hatred of government authority. Proudhon, for instance, believed that "government of man by man in every form is oppression," and that the highest perfection of society is found in the "union of order and anarchy." Not a few socialists regard the government in a capitalist society as a means used by the capitalists to exploit the workers; and they believe that when socialism is established, the government will cease to be the instrument of the ruling capitalists and become the agent of all the people.

MARXIAN SOCIALISM

Modern socialism should probably be dated from Karl Marx, who, in collaboration with Friedrich Engels, published the *Communist Manifesto* in 1848, and his own monumental work, *Capital* (*Das Kapital*) in 1867. Although Marx has recently been regarded as a communist rather than a socialist, his views are mainly socialist, and his significance in the socialist movement is so great that he must be considered here.

The *Communist Manifesto* was printed only a few weeks before the revolt of the workers, the Revolution of 1848, broke out. Marx took an active part in it and for a while believed that the workers would win and would set up a socialist state in France; but they were defeated, and thousands were shot or deported. He spent much of his life working as a propagandist for socialism but was hounded from one country to another until he finally found a haven in England, where he devoted himself to writing his *Capital*. As a personality, Marx was arrogant and domineering, generally contemptuous of those who differed from him, capable of profound sympathy with the masses but often unkind and ungenerous in dealing with individuals. He was perhaps moved less by a kindly and understanding sympathy with humanity than by an intense hatred of the men and institutions that he held responsible for the hardships and injustices suffered by the masses.

Marx's doctrines may be discussed under six headings: (1) the evolutionary point of view, (2) the economic interpretation of history, (3) the doctrine of surplus value, (4) the law of capitalist accumulation, (5) the class struggle, and (6) the revolution, the dictatorship of the proletariat, and the final classless society. The first five, or at any rate most of them, are accepted by most socialists and will be considered in this chapter. The sixth, however, stamps Marx as a revolutionary socialist—or a communist, in present-day usage—and its analysis will therefore be postponed for the chapter on communism.

The evolutionary point of view

One of the important contributions made by Marx is to be seen in his historical, evolutionary point of view. This was not entirely new, of course, but Marx developed it further than any of his predecessors. The economists who preceded him—Adam Smith, Ricardo, and John Stuart Mill—thought of economic institutions as unchanging and analyzed the operation of the economic system as it existed in their time, giving little attention to its earlier forms, to the changes that were even then taking place, or to its probable future development. Marx, on the other hand, a philosopher and historian—he might well be called a philosopher of history—viewed human institutions, including the economic system, as constantly changing. What Darwin did for biology, Marx did for economics.

The economic interpretation of history

Different men have interpreted human history in different ways. Starting with the assumption that man is a "political animal," Aristotle held generally to a political interpretation of history; the philosopher Hegel, who had great influence on Marx, interpreted history in abstruse philosophical terms; Henry Thomas Buckle, in his *History of Civilization in England*, elaborated a physical or geographical theory of historical development, according to which the character of populations, and to some extent historical developments, are determined by climate, soil, food supply, and the "aspects of nature"; Benjamin Kidd found the key to human history in religion. A great many historians have interpreted historical events as the result of the influence of a relatively few men—the "great-man theory." Before Marx's time and indeed until rather recently, most histories were the records of political and military leaders, with little reference to underlying economic conditions.

Marx turned away from the great-man theory in his conclusion that "legal relations as well as forms of state could neither be understood by themselves, nor explained by the so-called general progress of the human mind, but . . . are rooted in the *material conditions of life*. . . . The mode of production in material life determines the general character of the social, political and spiritual processes of life." In changing the modes of production, mankind changes all its social relations: "The hand mill creates a society with the feudal lord; the steam mill a society with the industrial capitalist. The same men who establish social relations in conformity with their material production also create principles, ideas and categories in conformity with their social relations."[3] Engels expressed the same theory in somewhat the same way: "In every historical epoch the prevailing mode of production and exchange, and the social organization following from it, form the basis upon which is built up, and from which alone can be explained, the political and intellectual history of that epoch."

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[3] See Harry Laidler, *A History of Socialist Thought*, p. 201.

Two misconceptions must be avoided. It is sometimes said that Marx thought that economic factors were the only ones which influence historical developments; but this is not true. He believed merely that the economic factors were the most important. His economic interpretation of history is also sometimes construed to mean that every individual or class is motivated entirely by economic interests; but his doctrine is not simply a "materialistic philosophy of life," although Marxians do stress material things in their philosophy.

Most students of Marx concede the great significance of his economic interpretation of history, for it throws a revealing light on many historical developments. Most of the American Indians, for instance, securing their living by hunting and fishing, held to communism in land because it was appropriate to their economic life; even their idea of heaven—a "happy hunting ground"—might be said to reflect their "mode of production in material life." Men who are disturbed by the rising tide of radicalism in our politics may find an important cause for it in the development of great factories with large numbers of propertyless laborers, and the gradual separation of workers from their means of earning a living. Our rising divorce rate is the result not so much of changing moral standards as of the economic emancipation of women, of better opportunities of making their own living. A few decades ago, Frederick Turner diverted the course of much historical research into new channels by emphasizing the importance of the frontier in American history, a definitely Marxian approach.

Many careless students believe that emphasis on economic factors in analyzing human history and human problems in itself represents the Marxian doctrine. This is not altogether correct, for Marx's theory is broader than this; yet his work led to increased emphasis on economic factors and conditions. Perhaps no historian illustrates this tendency better than Charles Beard, who usually looks to the economic factors behind historical developments. As he analyzes the Revolutionary War, for instance, it was not simply a struggle of good colonists against a wicked King, but a war that arose out of economic conflicts between the colonists and England, and was fought with the support of certain economic classes in both countries, other classes remaining apathetic or even hostile to it. Throughout *The Rise of American Civilization*, which Beard wrote in collaboration with his wife, he points to economic factors as fundamental in determining the turns of history. Perhaps he stresses economic factors too much, but certainly his books add a needed element to history which hitherto had dealt largely with trivial details of presidential personalities, military campaigns, and national heroics.

The doctrine of surplus value

Marx based his value theory on the works of Adam Smith and Ricardo, who had formulated a labor theory of value. Adam Smith said: "In that early and rude state of society which precedes both the accumulation of stock [capital] and the appropriation of land, the proportion between the quantities of labour necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another. If, among a nation of hunters, for example, it usually costs twice the labour to kill a beaver which it does to kill a deer, one beaver should naturally exchange for, or be worth, two deer." Although differing in some respects from Smith, Ricardo echoed this doctrine, declaring that labor was "the foundation of all value" and that the relative quantities of labor almost exclusively determine the relative values of commodities.

Starting with this theory, Marx proceeded to build up his theory of surplus value, which may be summarized as follows: Since the laborer no longer owns his own tools, he must find employment with the owner of capital. The entrepreneur, of course, pays him as little as he can, and he is able to keep wages down to the cost of production of the laborer, that is, to the level of subsistence for the laborer and his family. But the labor power exerted by a man working in a factory produces a net value in excess of his wage, and this excess is the *surplus value,* which the entrepreneur strives constantly to maximize. Thus the laborer is always being robbed of part of his product, and the entrepreneur or capitalist constantly waxes richer.

This summary does not cover all the refinements, intricacies, and obfuscations of the Marxian theory (even students of Marx are by no means in agreement on its real meaning), but it will have to suffice for our purposes. It is obvious, even from this summary, that the theory of surplus value is logically untenable. The labor theory of value is inadequate in our modern economy because it does not take into consideration the cost of capital, the sacrifice in saving. It is fallacious also in a competitive economy, for in such an economy the employer theoretically is forced to pay labor a wage equal to its marginal productivity. (All this has been discussed in the chapter on wages.) Monopolistic employers pay only wages equal to the marginal revenue productivity of labor, but Marx does not limit his doctrine to monopolized industry; in fact, he does not distinguish clearly between competition and monopoly.[4]

Although Marx's surplus value theory is thus logically untenable, there is, as we have seen, considerable evidence that labor as a whole does not receive enough wages to buy its own product. The report of the Brookings Institution comes to this general conclusion, but by a different method of analysis than that employed by Marx. The Brookings Institution held monopoly responsible for the excessive earnings of the employers and the deficiency of purchasing power in the hands of labor; Marx seemed to believe that the maldistribution of income was the natural and inevitable result of business operations, whether monopolized or not.

The law of capitalist accumulation

The greater the complexity of the productive process, according to Marx, the fewer will be the number of dominating capitalists. New means of communication, new mechanical inventions, new processes of every kind steadily increase the wealth and power of the ruling capitalist class but reduce the size of this class because they call for financial resources beyond the small capitalist. The capitalist system spans national boundaries and encompasses the world. While all this is going on, "in proportion as capital accumulates, the lot of the laborer, be his payment high or low, must grow worse. . . . Accumulation of wealth at one pole is, therefore, at the same time accumulation of misery, agony of toil, slavery, ignorance, brutality, mental degradation, at the opposite pole, i.e., on the side of the class that produces its own product in the form of capital."

With some of this analysis we must agree. One of the most unfortunate aspects of capitalism in its later stages, as we have seen, is its tendency toward larger and larger industrial units, and the concentration of management in fewer and fewer hands. This has progressed far since the days of Marx. It has appeared in the retailing business, for instance, within the recent past; for the heads of the great retail chains—probably ten or twelve men—control more business today than all the retailers in the United States did at the time of the Civil War, when Marx was writing. The theory of the increasing misery of the working class is, however, quite untenable. It is easy to see how Marx should have reached this conclusion, however, for the condition of labor in England was desperate when he was working on his *Capital,* and investigating committees were dragging some of this festering misery out into the daylight. Even at that, as Marx at one point concedes, labor was better off than it had been when the factory system first appeared; moreover, conditions have since improved greatly. Labor may not get its full share of the gains from increasing wealth, but on the whole it has enjoyed a rising standard of living.

The class struggle

Fundamental to Marx's general theory is the doctrine of the class struggle. Marx and Engels begin their *Manifesto* with the ringing pronunciamento:

> The history of all hitherto existing society is the history of class struggles. Freeman and slave, patrician and plebeian, lord and serf, guild-master and journeyman, in a word, oppressor and op-

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[4] See J. E. Le Rossignol, *From Marx to Stalin,* chap. 14.

> pressed, stood in constant opposition to one another, carried on an uninterrupted, now hidden, now open fight, a fight that each time ended, either in a revolutionary re-constitution of society at large, or in the common ruin of the contending classes.
>
> In the earlier epochs of society, we find almost everywhere a complicated arrangement of society into various orders, a manifold gradation of social rank. In ancient Rome we have patricians, knights, plebeians, slaves; in the middle ages, feudal lords, vassals, guild-masters, journeymen, apprentices, serfs; in almost all of these classes, again, subordinate gradations.
>
> The modern bourgeois [capitalist] society that has sprouted from the ruins of feudal society, has not done away with class antagonisms. It has but established new classes, new conditions of oppression, new forms of struggle in place of the old ones.
>
> Our epoch, the epoch of the bourgeoisie, possesses, however, this distinctive feature; it has simplified the class antagonisms. Society as a whole is more and more splitting up into two great hostile camps, into two great classes directly facing each other: Bourgeoisie and Proletariat.

Laski has summarized the theory of the class struggle perhaps better than any other writer:

> The emergence of private property in history is the beginning of the class struggle. Immediately society can be divided into those who do, and those who do not, possess private property, a power is released which explains the changes of history. For the class which possesses property moulds the civilization of that society in the service of its own interests. It controls the government, it makes the laws, it builds the social institutions of the commonwealth in accordance with its own desires. Slave and free man, master and servant, these have been the eternal antitheses of history. With the advent of capitalism the struggle is at once simplified, and made more intense. Thenceforward, the final stage of the class-war, the struggle between the bourgeoisie and proletariat, emerges. And just as each social order of the past has secreted within its womb the germ of its successor, as for instance feudalism produced capitalism, so does the latter contain within itself the germ of its communist [socialist] successor.[5]

Thus, according to Marx, there are only two important classes. The bourgeoisie steadily grow richer, while, as he puts it in the *Manifesto,* "the modern laborer, . . . instead of rising with the progress of industry, sinks deeper and deeper below the conditions of existence of his own class." The middle class tends steadily to sink into the proletarian class: "The lower strata of the middle class—the small tradespeople, shopkeepers, and retired tradesmen generally, the handicraftsmen and peasants—all these sink gradually into the proletariat, partly because their diminutive capital does not suffice for the scale on which modern industry is carried on, and is swamped in the competition with the large capitalists, partly because their specialized skill is rendered worthless by new methods of production. Thus the proletariat is recruited from all classes of the population."

But the conditions developing with capitalist production are increasingly unfavorable to rule by the bourgeoisie; for as more and more people are forced into the proletarian class and as increasing numbers of laborers are brought together in the great industries, the workmen learn to organize and cooperate. In the ensuing struggles between the proletariat and the bourgeoisie, the bourgeoisie is usually victorious at first; but finally the workers win, overthrow the bourgeoisie, and open the way for the "sway of the proletariat." "The development of Modern Industry, therefore, cuts from under its feet the very foundation on which the bourgeoisie produces and appropriates products. What the bourgeoisie therefore produces, above all, are its own 'grave diggers.' Its fall and the victory of the proletariat are equally inevitable." This victory is to be world-wide, not limited to national boundaries, because "the working men have no country."

This proclamation that "the working men have no country" is one reason why Marxian socialists, and to some extent almost all other socialists, have been subject to much public criticism. Socialists believe that the real enemies of the masses are the bourgeoisie of their own country, not the masses of another country, and that the real war is thus a class war, not a war between nations.

What shall we say as to the validity of some of Marx's views on the class struggle?

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[5] Harold Laski, *Karl Marx, an Essay, with the Communist Manifesto,* pp. 36–37. By permission of the League for Industrial Democracy.

As to the reality of the class struggle itself, Marx was sound. As Laski has said: "The fact of the class-struggle, as Marx himself pointed out, is a common-place of historians and economists; and it may be added that to deny its importance is to make history unintelligible." It is true that what Marx calls the "exploited classes" have not always struggled very violently, for in earlier historical eras the classes that were really exploited ruthlessly were singularly docile and resigned. Although there were some uprisings—the Spartacan Revolution in Rome, the Peasants' Revolt in central Europe, the Wat Tyler insurrection in England, the French Revolution, and the widespread labor revolution of 1848—the miserable slaves of Roman times and the serfs of the Middle Ages accepted their lot without violent protest, probably in the belief that it represented the natural order of things.

In more recent times the proletarian class has shown greater class consciousness, particularly the laboring class which, as Marx says, is the "only revolutionary class." Many people strongly resent the suggestion that there are real class differences in America, and hate with almost pathological enthusiasm men who, like President Roosevelt, appeal to the class consciousness of labor—"stir up class hatred," as they put it. They insist that we are all one happy family, democratically constituted and democratically governed, and that the interests of all are the same. It appears, however, that this identity of interests works only one way What is good for business leaders is presumed to be good for labor; but there is no assumption that what is good for labor is good for business leaders. Thus when a political administration follows the wishes of our entrepreneurs and capitalists, there are—or should be—no class differences; but when Congress enacts legislation called for by labor, the happy family is promptly disrupted—by the very men who insist that it is a happy family and who object to the idea of class differences. Furthermore, although labor and capital have an identical interest in the profitable operation of industry, for neither can prosper if this is lacking, diversity of interest appears as soon as they begin to divide up the gross profits.

It would of course be an exaggeration to say that the history of the United States is largely a record of class struggles, yet it is that to some extent; but in the early history of the country the struggles were not so much between capital and labor as between commercial and agrarian classes, between creditor and debtor classes—which means, to some extent, between the rich and the poor. It will be remembered that some of the colonies made property ownership a qualification for voting, and that this qualification was fairly high in the case of assemblymen. Thus, at the beginning of our nation's existence, political power was concentrated in the hands of propertied men, and one of the political issues for a long time was the extension of political rights to the lower classes. The Beards state that when the Constitution was being drawn up, "Almost unanimous was the opinion that democracy was a dangerous thing, to be restrained, not encouraged by the Constitution, to be given as little voice as possible in the new system, to be hampered by checks and balances." They quote Alexander Hamilton to the effect that "all communities divide themselves into the few and the many. The first are rich and well-born and the other the mass of the people who seldom judge or determine right."[6] Hamilton was always the advocate of the "rich and well-born," whereas Jefferson was generally sympathetic to the "mass of the people." John Adams, like Hamilton, thought of political society as a conflict between the rich and the poor, and of government as functioning to set bounds to the claims of both classes. The early political line-up between Federalists and Republicans represented the class cleavage between the rich and the poor, and engendered such rivalry and bitterness as to threaten the Union.

We need not trace this thread down to the present, but certainly class antagonism has been an important issue in national politics. For a while after the Civil War the Republican party was dominated by the financial and commercial interests of the North, and the Democratic party represented the agrarian and generally poorer South and a growing proletariat in the large cities. The Democratic party itself, however, presently came under control of powerful business interests, and some of our presidential campaigns have represented little but shadow boxing by candidates, both of them controlled largely by the same group of men, with occasional flurries of discontent on the part of genuine opposition parties, such as the Populist party. In recent campaigns, particularly since Franklin D. Roosevelt became President, the class cleavage has been much clearer; the bitterness of the last three campaigns, in which Roosevelt was supported by the working people of the large cities and the masses of the South, while the Republican candidate was supported by the businessmen and to some extent the farmers, indicated clearly that the class struggle is an American reality.

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[6] Charles and Mary Beard, *The Rise of American Civilization*, vol. i, pp. 315, 316.

We cannot, however, give unqualified assent to the doctrine of the class struggle, as Marx elaborated it. In dividing the people into bourgeoisie and proletariat, and in giving little attention to the middle class, he made the matter too simple. The "ruling class" is usually fairly well unified, but the rest of the people cannot be lumped together as proletarians. Marx underestimated the importance of the middle class and greatly exaggerated the rapidity with which it would fall into the class of the proletariat. The tendency of capitalism is indeed to reduce the relative importance of the middle class; in fact, its decline has probably been going on in America for some time, for more and more farmers have reverted from landownership to tenancy, and more and more individual retailers have been driven out by the chain stores, whereas the number of wage workers has increased greatly. On the other hand, there has been a marked increase in the number and proportion of workers in the various service occupations, particularly clerical and professional, and most of them should be rated as belonging to the middle class.

Marx was undoubtedly too pessimistic about the future of the middle class, and he made his classification of society too simple. There are a great number of classes, shading from the wealthiest capitalists down to the poorest day laborers and sharecroppers, from professional men with generous or comfortable incomes to rural preachers and teachers who barely manage to live, from salesmen who earn much more than a comfortable living to hawkers who make only enough for a miserable existence, from highly skilled craftsmen whose incomes equal those of the average doctor or lawyer to the unskilled and casual laborers who must go on relief whenever jobs are scarce. Even the laborers themselves are by no means an undifferentiated proletariat, for the ranks of labor have recently been split by what is to some extent a class struggle—the labor aristocrats of the American Federation of Labor on the one hand and, on the other, the industrial workers of the Congress of Industrial Organizations.

REVISIONISM

Even while Marx was working for his "inevitable revolution," the "revisionist" movement, a more moderate socialist movement, was developing in Germany; and thirty years after *Capital* was published, Edward Bernstein, the leader of the revisionists, pointed out some of the more obvious errors in Marx's doctrines. His criticisms of Marxian socialism have been outlined as follows:

1. The collapse of the capitalist system is not imminent, as Marx believed. While Marx was correct in his statement concerning economic evolution as a general tendency, he underestimated the time required to bring the socialist state into existence.

2. Social conditions have not led to so acute a conflict of classes as Marx pictured. The number of capitalists is not declining, and although the middle classes may change in character, they are not disappearing.

3. Concentration of industry is not proceeding with equal rapidity and extent in all lines of industry. In agriculture, for instance, its advance is rather slow.

4. Largely because of the pressure of working-class organizations, factory legislation and the democratization of local government have reduced many of the evils of capitalism that Marx described. When Marx wrote, there was little legislation for the protection of labor; but between 1867, when *Capital* was published, and 1899, when Bernstein published his *Evolutionary Socialism,* there was a great advance in such legislation.

5. Marx was wrong in emphasizing the final end of the evolutionary process. Bernstein emphasized the necessity of a steady advance without much regard to the final end to be

achieved, for this he could not clearly foresee.[7]

Bernstein made many other significant criticisms of Marx's views, but they cannot be elaborated here. It must be conceded that most of his strictures are valid, and that the socialism he advocated is definitely more appealing than that outlined by Marx.

SYNDICALISM

One of the most characteristic forms of radicalism in France is known as syndicalism, which may be described briefly as follows:

1. Like the Marxians, the syndicalists believe in the class struggle.

2. The syndicalists advocate "direct action," that is, any form of direct pressure, including violence, that the workers can bring to bear on the employer. They advocate the strike, even the general strike—that is, a strike of all workers in all industries—if necessary to enforce their demands, as well as the boycott and sabotage; but they are generally opposed to political action because they regard the state as merely the instrument of "class rule."

3. The most characteristic feature of syndicalism is perhaps the belief that the unit of social organization should be the trade union or *syndicat* (hence the name), that the most important task is to increase the membership of these *syndicats,* and that the *syndicats* will be the unit of political control in the socialist state.

DEMOCRATIC SOCIALISM

Meaning of democratic socialism

Following the general concept of most American socialists, we may define socialism, democratic socialism, as *the public ownership and operation, in accordance with democratic principles, of the socially important productive industries.* The socially important industries would include the banks, railroads, public utilities, mines, smelters, mills, factories, hotels, apartments, wholesale and jobbing establishments, and department stores; the great chain stores would be either socialized or broken up, as would also agricultural units large enough to be "socially important." There is some disagreement as to farms, individually owned retail stores, and small service establishments; they might be left in private hands. Clearly such productive capital as the housewife's sewing machine and the woodman's ax would be privately owned, and consumers' goods would be privately owned. Under a socialist regime a man might own his home and its furnishings and his automobile, and he could spend his wages in any way he pleased; but he could not own a "socially important" factory, or probably even a house or a farm that was to be rented to others.

No precise line can be drawn between the industries which would and those which would not be socialized; but it is possible that the principle employed in Russia might be used to some extent, although the autocratic Soviet Union is not the ideal for democratic socialists. The fundamental characteristic of the Soviet regime is the elimination of profit, *private* profit. In Russia a man can operate a retail shop or a repair shop, but he cannot make a profit from hiring other labor or from renting his shop to someone else. He must operate it himself and do the work himself. If the socialist state left stores and shops and farms in private hands it would doubtless regulate their operation closely, for there would be a general economic plan into which such enterprises would have to fit.

Would the industries be owned by the federal, state, or local government? Most of the important industries are so tightly integrated on a national scale that they would have to be operated by the federal government; but there are other industries and businesses that might well be operated by the states and municipalities, as in Soviet Russia.

From the foregoing it is clear that most of the labor, perhaps nearly all, would be hired by the government—federal, state, or local—and that wages would be the only functional income going to private individuals. Profits, rent, and interest would go largely to the government. Whether all workers would receive the same wages or whether there would be wage differentials as under capitalism is a question on which socialists disagree. Russian experience suggests that some differentials would be required in order to provide an incentive for diligence and industry and in order to attract enough labor into disagreeable kinds of work.

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[7] Harry Laidler, *A History of Socialist Thought,* p. 297.

Democratic socialists are fairly well agreed that the change to socialism is to be achieved by democratic means, by convincing a majority of the voters that it is necessary and that the socialized industries will be operated democratically, not by an irresponsible government dictatorship. The Fabian socialists believe that socialism will come gradually, and inevitably. The Fabian doctrine of "gradualness" is accepted by most socialists today; but the "inevitability" does not seem as inevitable as it once did. Although the government of every capitalist country has steadily expanded its functions, most such governments have reached only the fringes of the great area of private enterprise, and there is reason to doubt that our government, at any rate, will take over this vast field in any future that can be foreseen clearly. Probably one reason why businessmen were willing to yield some productive activities to the government without serious resistance is the fact that the field of private enterprise also expanded—both extensively, in the settlement and exploitation of new lands, and intensively, in the rapid development of new industries and the expansion of production. As long as this hopeful expansion continued, there was little occasion for bitter class struggles, since all classes were generally fairly well satisfied; but in the stagnant economy of 1929 to 1939 the government invaded various new fields while private enterprise expanded very little, and as a result there was much bitterness on the part of the business classes. This situation in Germany led not to a peaceful advance toward socialism but to Fascism, financed by wealthy capitalists. There is some reason to believe that the "inevitable" end of the gradual expansion of government functions may be not democratic socialism, but Fascism. Threatened with the loss of their power and prestige, the ruling classes may forcibly overthrow the democratic political regime and take the vote away from the people.[8]

Character of socialists

There is a widespread notion among those whom Taussig calls "the well-to-do people of the half-educated sort" that socialism means a "red flag and a reign of terror," and that socialists are a "lunatic fringe" of sinister men and women who spend most of their time plotting against the government and against the good, honest, industrious, and competent people who are trying to build up American civilization. As far as the genuinely socialist movement is concerned, this notion is grossly false. As Taussig says, "Brotherly love, rather than hatred or envy, underlies the movement." Most socialists are also people of more than average education and intelligence. The soundness of their judgment and the validity of their conclusions always have to be judged by future generations, but it has often been observed that from the perspective of later history many of their views are surprisingly sagacious. Seba Eldridge's study indicates that socialists average much higher in "public intelligence" than the members of the more conservative political parties; in our colleges, the proportion of socialists in the different departments varies directly with the amount of training in the social sciences; it is low in schools of law and engineering, where there is almost no study of the social sciences, and relatively high in departments of economics, sociology, history, psychology, and political science.[9] A corollary to this might be that the only way to eliminate the ominous "radicalism" of our colleges is to eliminate the study of history, economics, sociology, political science, and psychology. This would not be sufficient, to be sure, for many students taking courses in English and foreign languages read widely, and the proportion of radicals is fairly high; hence it might be wise to eliminate the study of all literature. In fact, it might be best to close our schools or reduce them to the function of propaganda agencies, just as Adolf Hitler did.

Such socialist leaders as Eugene Debs, John Spargo, and Norman Thomas have been men of wide and intimate knowledge of social, economic, and political problems, and have been moved by a passionate love for humanity and an unselfish devotion to the principles of democracy. It is unjust to picture them, and most of their followers, as self-seeking, for in propagandizing for socialism in the hostile political atmosphere of the United States, socialists always have to sacrifice something in personal ease, monetary income, and the esteem of the upper and middle classes. As far as material things are concerned, they could do much better for themselves if they were in business and belonged to a conservative party. Many Marxians are contemptuous of democracy, but it would be grossly unfair to think that American socialists represent a threat to democracy, for as a rule they are more sincerely interested in its preservation than are their uninformed critics.

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[8] An excellent discussion of this point is to be found in Harold Laski, *Democracy in Crisis*.

[9] Seba Eldridge, *Public Intelligence*.

The socialist argument

The traditional socialist argument runs generally along the lines of criticism of the existing order and of the wastes of competition—advertising, salesmanship, and duplication of plants and services. Socialists claim that more than half our energy is thus wasted. They point to the growing monopoly in our economic life, and argue that government monopoly is preferable to private monopoly. They stress the grotesque inequalities of income—the high proportion of unearned fortunes, and the tragic poverty, insecurity, and destitution of a large part of our population, all the more tragic in a country which could well produce enough for a fairly decent life for all. They complain of the domination by the rich of our press, pulpit, schools, and our culture in general, and maintain that political democracy is impossible without a greater measure of economic democracy than we now have. Finally, they argue that capitalism demands imperialism and that imperialism has been the cause of most wars; wherefore they insist that since all wars are imperialist, no war is ever justified, which makes pacifism the only reasonable position to take.

Some pros and cons on socialism: the problem of human character

It is often said that socialism would be very fine if people were very fine, but that people are too selfish to respond to the idealism of a socialist system. Here we encounter a divergence of views that has persisted since the time of Plato and Aristotle. Plato, the first great radical—a communist rather than a socialist, as we now understand socialism—thought men would respond to other than economic motives, for the "guardians" were to have no property of their own and the ruling "philosophers" were assumed to be indifferent to money. Aristotle, the first great opponent of communism, held a less favorable view of human nature, as we can see from his argument: "That which is common to the greatest number has the least care bestowed upon it. Every one thinks chiefly of his own, hardly at all of the common interest; and only when he is himself concerned as an individual," and from his famous statement, "Men are more desirous of gain than of honor." Aristotle regarded the love of private property as natural to man: "And how immeasurably greater is the pleasure when a man feels a thing to be his own; for the love of self is a feeling implanted by nature and not given in vain, although selfishness is rightly censured." These arguments against communism, which are to some extent pertinent also against socialism, are about as sagacious as any that are offered today.

Socialism does indeed assume a less acquisitive disposition in human beings than our present system does. Our grotesque inequalities in wealth and income—if they have any logical foundation at all—rest on the assumption that only by offering fabulous prizes can we induce capable businessmen to do their important work of managing and directing productive enterprise. Salaries paid by business corporations run as high as $500,000 a year or, if bonuses are included, $2,000,000 a year. No such prizes would be offered in a socialist state, for the philosophy of socialism is strongly equalitarian. These extreme inequalities of income do not appear in government service. We assume that we can get able men for our Supreme Court—whose function is quite as important as that of any corporation's board of directors—for $20,000 a year, Cabinet officers for $15,000, and Senators for $10,000. The President receives $75,000, only as much as the president of an ordinary middle-sized corporation. There is reason to believe that a socialist government could secure nearly as good entrepreneurial services as we have today for much smaller compensation.

Socialists are inclined to argue that if people are conceded to be essentially selfish, they are so partly or largely because of environment and tradition, because from the cradle to the grave they are made constantly aware of the heavy emphasis on money as a measure of reputability; and they insist that if environment and training stressed other ideals, people would respond to them almost as well, if not quite as energetically, as to the love of lucre. Certainly there is some truth in this view. Many men leave highly remunerative positions in business to accept modestly paid government posts in which their compensation consists in honor or in the satisfaction of doing a great public service. Many university teachers could earn far more in business, but prefer to take their compensation partly in other forms than money. Officeholding in the socialist state might carry with it so much honor and distinction that able men would be willing to serve for modest salaries. Some do this, even in a capitalist economy.

Whether human beings could ever be so reared and educated that they would largely lose their selfish desire for individual possessions and personal gain, whether they could ever be trained to find in collective ownership and gain somewhat the same satisfaction that they now find in individual ownership and gain, is quite another question. The desire for personal possession is deep-rooted, and the present writer feels no strong confidence in the unselfish motives of most people. Yet we must concede that the opportunities for personal ownership are declining anyhow, and that man is apparently adjusting himself to a world in which fewer and fewer people think of it as essential.

Selfishness, *intelligent* selfishness, would not necessarily make socialism impracticable. If socialism were really a more efficient form of economic organization, intelligent selfishness should lead most people to favor it. Those who have profited handsomely under the capitalist regime would of course be hostile, but they constitute only a small proportion of the population. Moderate democratic socialism, which did not include farms and small retailing establishments, would deprive less than 1 per cent of the people of the opportunity to amass fortunes.

Human intelligence and socialism

More important than the question of human selfishness is undoubtedly the question of human intelligence. To the extent that the capitalist system really works well, it calls for little public intelligence. If in seeking their own interests men are guided by Adam Smith's "invisible hand" to serve also the public interests, obviously the government needs only to preserve law and order and establish certain rules for business. "The best government is the least government"—the best because government intervention can mean only interference with a naturally beneficent process; a corollary might be: "The less government there is, the less public intelligence is needed." The problems of government were rather simple two or three generations ago, when capitalism usually operated to provide fair employment and reasonable security. In a socialist society, with the government operating the important industries, a hundred problems would demand the attention of the people, would have to be solved by them *as voters,* unless they were content with whatever kind of administration the bureaucrats provided—a course fraught with grave danger to their liberties. Democratic socialism requires a keen public interest in government problems, and a higher level of public intelligence than can be found in any country in the world, perhaps higher than has ever been recorded in history. The fact that people have been able to operate a capitalist system successfully does not prove that they could run a socialist government.

Granted that people may have the necessary mental resources, there is the further question whether they would be willing to use them in studying government problems, or whether, as at present, they would prefer poker and bridge and the movies. Most individuals find any sort of hard thinking distasteful, and it is not certain that they would be willing to give serious attention to the problems of government when there are so many ways of entertaining themselves without mental strain. Perhaps they would. As is evident from the example of the Scandinavian countries, if the study of economics and politics becomes the conventional thing—we might say the "fashionable" thing—people will work at it with genuine interest and enthusiasm just as Americans work at poker and bridge with keen and unflagging interest.

Organization of production under socialism

It is sometimes argued that a socialist government would inevitably break down from the sheer difficulty of organizing such a large number of complicated productive enterprises. There would certainly be difficulties, and in some cases the task might be done badly; but for that matter some businesses today are poorly organized and administered and grossly wasteful of human energies. Furthermore, as Taussig has pointed out, the large-scale enterprises of the present have gone far to disprove this argument.[10] If a private individual can manage a five-billion-dollar concern like the American Telephone and Telegraph Company, a government-chosen manager might be able to do so without too great difficulty. Socialists often point out that the drift of private enterprise toward great combinations has provided ideal conditions for socialization. The government now operates such enterprises as the postal service, the Reclamation Service, the Forest Service, and the Tennessee Valley Authority; and its efficiency in conducting them is probably not inferior to that of private enterprise on the average. Furthermore, the government could save a great deal in cases where private enterprise inevitably involves waste, as in the cost of advertising, salesmanship, cross freights, and general duplication of services.

Yet there may be valid doubts as to the general efficiency of government enterprise, particularly with respect to the function of management. Could the government secure as efficient managers as those at present in industry? We might doubt that it could, even if we concede that today public enterprise is as efficient as private enterprise, for in many cases the government secures the services of men who have been winnowed out by private competitive business. In the event of socialization, the government might keep as managers the men now in control, and thus might start with good management, perhaps better than ever before because it would be free from the domination of the acquisitive spirit. But is there not a possibility that when these men passed from the scene, their successors might lack some of the vigor and alertness inherent in private enterprise? Socialists have not always indicated clearly how they would choose the important managers of industry, and there is reason to doubt that they would select men as able as those found in private competitive business. Taussig has little doubt on this point: "It is well-nigh impossible to conceive that any governmental organization, democratic or autocratic, will be able to pick out the men who are at once imaginative, venturesome, and clear-headed."

Carver likewise believes management under socialism would be inferior to that under a capitalist society. In a capitalist society, he points out, we choose industrial managers by "spending our dollars" for the goods of which we approve, thus "choosing" the managers of the concerns that produce those goods, in preference to the managers who produce goods that we do not like so well. In a socialist state, however, we would choose the managers by "casting our votes"; and since we do not do this with as much thought and intelligence as we spend our dollars, our choice would not be so wise. To the extent that there is competition in industry, this argument is logical; but to the extent that industry is monopolized, we have less chance to choose goods, and therefore managers.

When we say that private entrepreneurs may be more efficient, we must be cautious in defining efficiency; for efficiency in conducting a particular private business may be gross inefficiency from the broad social point of view. Jay Gould was a shrewd businessman, wholly efficient in promoting his own personal interests, but he was doubtless a heavy detriment to society as a whole. The efficiency of the Rockefeller group in promoting their oil monopoly was not social efficiency. The efficiency of the managers of the United States Steel Corporation in earning profits by keeping its labor force in a state of helpless peonage was not social efficiency, for labor of the type that the steel men had in their mills and slums is always a danger to democracy. The efficiency of advertisers in convincing buyers that there is "not a cough in a carload" or that fifteen bottles of Dr. Jenks's Vegetable Compound will cure fifteen diseases is not social efficiency.

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[10] F. W. Taussig, *Principles of Economics,* 4th ed., vol. ii, pp. 507, 508.

Even if the managers in a socialist society were individually less competent than those in a capitalist economy, they might be able to provide quite as well for the needs of consumers, because they could eliminate some of the wastes of competition. If, for instance, the government owned and operated the railroads, the managers could avoid some duplication of lines, or where lines run parallel they could use some for freight and others for passenger traffic; and they could fix timetables in such a way as to give passengers better service. In some stations today, two or three trains may leave at about the same time bound for the same destination, and then there may be no more trains for several hours. Government operation, with coordination of the railway system of the entire country, would have some advantages. On the other hand, it would be at a disadvantage in some respects as compared with private operation. Railways employees, representing a large bloc of votes, might be able to force upon the management even more onerous labor rules and restrictions than those from which private managers suffer today.

This brings forth a principle of the highest importance. Private entrepreneurs *always face the necessity of keeping costs down to receipts.* When they cannot do this they must—and in most ordinary types of business they should—close shop. If the receipts of an ordinary business do not balance costs, the business is presumably being carried on at a social as well as an individual loss. If people living on a railroad spur, for instance, are not willing to pay the cost of operating that spur, it should be abandoned, and the labor and capital should be turned to the production of some good or service that the public wants badly enough to pay for at a cost price. The stern necessity of making ends meet, under capitalism, is a conserver of society's productive energies which might be lost to some extent under socialism, for various unprofitable businesses in which local communities were interested might be maintained partly at public expense and at a social loss. This is true of some enterprises already undertaken by the government—certain canals and river navigation projects, irrigation systems, highways, and some PWA and WPA improvements. Government expenditures to promote health, culture, and good citizenship cannot of course be judged from this point of view, because hospitals, museums, and schools should not be expected to pay their way. Furthermore, during a depression the government may well undertake projects in order to provide employment, on the theory that if the unused labor of the unemployed can be used in producing goods and services of any value whatever, society will gain by just so much. It is better to waste labor partly than to waste it altogether.

Wages in the socialist economy

The problem of wage adjustment would present serious difficulties in a socialist society. There are three possible principles that might be followed in the apportionment of wages. The first, which is advocated by a few socialists, calls for apportionment according to need. This would amount practically to equality of wages, although some inequality might be allowed to cover differences in need; for instance, wages might be higher for married men than for celibates. Such a scheme is highly idealistic, fit for angels but not so well adapted to human beings. It is true that in the Amana Society of Iowa a principle much like this was in operation for nearly three generations, but its members were deeply bound together by religious ties; even so, the Society finally had to abandon its communism and adopt the corporate form, in order to get the necessary work done. The Bolshevik government of Russia maintained equality of wages for a while but eventually was forced to introduce wage differentials. It is highly doubtful whether most men, whatever their environment and training, would work hard to develop skill and proficiency if thereby they gained nothing in wages. Some of the better-paid professions require many years of hard study, whereas a grocery clerk can learn his work fairly well in a few months without expense, or even at a small salary. If there were no wage differences between these two lines of work, how many men would be willing to prepare for the professions?

A second possible principle of wage determination would be payment according to sacrifice. Under this principle, wages would be high in those occupations which are particularly dirty, wearing, or irksome; but pleasant and agreeable work would be paid for at a lower rate. In determining the irksomeness of labor, it would of course be necessary to consider the training required, and this might put the professions in a high-wage class. To the extent that people have equal abilities and equal opportunities, this principle is in operation today, for dirty and disagreeable work commands higher wages than clean and pleasant work requiring the same abilities. The fact that so often the reverse principle—pleasant work paid for at high wages, and dirty, disagreeable work done at low wages—is in operation is due to differences in natural abilities and in opportunities. Under socialism, opportunities could to some extent be equalized, but differences in abilities would persist.

The third possible principle of wage determination would be payment according to efficiency or productivity. However strongly the ideal of equality may appeal, some adjustment of wages to efficiency is expedient in order to call forth everyone's best efforts. Many people think that an ethical principle is involved, that it is right and just to pay more efficient workers higher wages, but this is an error. There is nothing ethical about it, no clear principle of justice; but it is probably expedient to pay according to efficiency, because otherwise no worker would have a strong incentive to increase his efficiency. Even Marx conceded that during the transitional period, before the classless society was achieved, wages would have to be adjusted in this way.

The problem of fixing wages for hundreds of kinds and grades of work would present baffling difficulties; and the government could probably do no better than to follow the same principle that is applied today, the principle of demand and supply. Having determined how much of a given commodity was to be produced, the government might fix the wages for every type of work involved in production at a point which would call out the supply of labor needed. Unless it resorted to compulsion, it could not offer less; if it offered more, it would be obliged to choose among a great number of candidates and would work an injustice on those not chosen. A socialist government would probably try to iron out great inequalities as far as possible; and by providing better living conditions for the poorer classes, it might be able to reduce wage inequalities based on differences in environment, health, and training; but some differences would still remain.

Labor unions in the socialist economy

In a socialist as in a capitalist society, labor unions would be a complicating element. Labor unions in strategic industries such as railroad transportation would be able to exploit their position, just as they now do. Presumably labor would be more widely organized than it now is, or all of it might be organized, and this would enable the now relatively helpless classes to protect themselves to some extent from the more powerful groups. If all labor was combined in powerful organizations, the government might represent largely a battling ground for the unions, with the stronger ones maintaining an unfairly advantageous position for themselves, as they do now. A socialist government would be more directly subject to pressure from labor groups than our present government is; and if any part of the economy, such as farming and small retailing, were left in private hands, it might suffer under the dominating power of organized labor so much that the government would have to take it over. In a capitalist economy the employers to some extent perform the function of protecting the general public against the exactions of labor groups, and government managers probably could not do this so well, although they would not have the same incentive, either, for exploiting helpless laborers.

All this is based on the assumption that labor unions, as now organized, would persist in a socialist economy; but Gagliardo suggests that this would be impossible. Certainly the Russian workers' organizations do not function like ordinary labor unions, but in such semi-socialist countries as New Zealand, Australia, and Sweden unions are very strong. Much would depend on the nature of the socialist economy. If it were highly autocratic, unions would doubtless have to take a position of subservience; but if it were genuinely democratic, labor unions not much different from our own might persist. In any case they would have to develop a sense of social responsibility which some of our present unions do not have.

The socialist state would have to provide an extensive civil service system for most kinds of workers, because it could not well trust promotions and demotions to the judgment or caprice of individual managers or foremen. Civil service, however, although necessary in government service, is inelastic, routine, and unprogressive, and hence would be unlikely to bring forth the alertness and inventiveness characteristic of private industry at its best.

Industrial management and progress in the socialist state

It is often argued that a socialist economy would be less dynamic than our capitalist economy is, less progressive technologically, more afflicted with routine and red tape. This might be true; laborers might not work so hard, managers might be less efficient and might not scheme and worry so tirelessly, changes and improvements might not follow each other with such kaleidoscopic rapidity. It is not certain, however, that socialism would be less dynamic or less progressive technologically than our monopoly-ridden capitalism. Some of our big industries—for instance the railroads—lack much of the dynamic alertness and progressiveness seen in private industry at its best. Moreover, in comparing managements, government-chosen managers should be compared not with individual competitive businessmen but with self-perpetuating officers of corporations which to some extent are in a position of monopoly. It will be recalled that large corporations often buy up inventions solely to suppress them, and that they are always under inducements to keep down production. Socialist managers would presumably have no incentive to suppress patents or restrict production. Although our capitalist corporations do carry on a great deal of research work, the Soviet government is reported to be spending for research vastly more than all the research agencies in the United States. Russia's surprising military effectiveness in the second World War suggests the possibility that socialism may in reality be more progressive technologically than capitalism, but we shall reserve judgment on this for a while.

Even if socialism proved less dynamic technologically, this would not be altogether unfortunate. Americans need many things more than they need new inventions, gadgets, wheels within wheels. They need time to live; and a less dynamic economy might help to meet this need. More leisure might be worth as much as more new goods.

Socialism and government corruption

One argument against socialism that can be easily disposed of is that socialism could not succeed because of the inevitable crookedness of government officials, which would be extremely serious if the government were carrying on a vast number of enterprises. Many people find happiness and relaxation in talking about the laziness, incompetence, and dishonesty of politicians and government officials. Whatever may be said as to the laziness and incompetence —and it is easy to say too much—government officials maintain higher standards of integrity and honesty, in some ways, than are found in private business. We have seen, for instance, that some 25 per cent of our corporation officials got their positions through the influence of some relative in the organization; despite our Senators' and Representatives' custom of hiring relatives for secretarial positions, nepotism is rare in federal government bureaus. A good illustration of this difference between government and business standards may be seen in the story of the Teapot Dome scandal—the attempted theft of our government's naval oil reserves during the Harding administration. In this case corrupt businessmen bribed corrupt or stupid government officials; but when the facts were brought to light every important government official involved was promptly retired in disgrace to private life, whereas the oil magnates implicated in the bribery of these officials suffered practically no criticism from their business associates. Socialists point out that big business is usually responsible when government officials are corrupted, and that if there were no big private business there would be no one to corrupt the government.

A people's standards of integrity are largely a matter of tradition, and it is possible that a socialist government might develop high ideals of public service if the people really wanted them. The United States has much higher standards today than she did a century ago, and this rise has occurred while the government was steadily expanding its activities. But if the people do not care about honesty in government, they will fare badly no matter what economic system they live under.

Socialism and the allocation of productive factors

Much has been written in recent years about the problem of allocating productive resources to the production of different kinds of goods, of guiding production in a socialist state. How could a socialist planning board determine how much capital should be devoted to the production of steel, aluminum, houses, automobiles, electric refrigerators, furniture, clothing, food, books, music, and all the other various goods? According to Mises, such an allocation would be impossible, theoretically as well as practically, in a socialist society; and others—Hayek and Robbins, for instance—agree that, although theoretically possible, practically it would be impossible.

We have already seen that in a "free market"—in a competitive economy—capital and labor are assumed to flow to the various productive industries until the marginal productivity of these factors is equal throughout all the industries; at this point price is equal to marginal and average cost. If consumer preferences for the various types of goods change, the prices of the more preferred goods rise, and the resulting profits attract labor and capital until prices and marginal costs again reach equality and the profits disappear. In the free market of a competitive economy prices are assumed to guide capital and labor into the production of the things which consumers marginally want most, and to guide consumers' purchases to the goods which have the highest marginal utility; and in equilibrium price is assumed to secure from a given amount of capital and labor the goods which will have maximum utility. The equalization of marginal costs and price is presumed to be brought about by the entrepreneur through trial and error, and Mises and his school contend that this trial-and-error method would not be possible in a socialist economy.

The difficulty of allocation would arise in the market for capital goods and productive resources, not in the market for consumers' goods, for the latter would constitute a kind of market where supply and demand could have some play, although not the free play of capitalism. The critical difficulty—or the impossibility, according to Mises—would appear in the market for such productive factors as iron, steel, lumber, machine tools, and other productive goods whose demand is "derived" from the demand for consumers' goods. How, for instance, would a socialist government allocate capital to the mining of iron ore, the smelting of pig iron, the manufacture of steel, the fabrication of steel into various products, and the building and operation of railroads?

It is impossible to enter here into all the refinements of theoretical analysis called for by this problem. In opposition to Mises and his followers, Lange reaches the conclusion that the allocation of productive resources is possible, both theoretically and practically. Lange believes that government managers could solve the allocation problem by trial and error, much as private managers do under capitalism, but the government would have to install an elaborate accounting system. Taussig also believed that allocation could be handled successfully in a socialist economy. The best argument on this point, of course, is the fact that the allocation problem is being solved with apparent success in Russia, although not under a democratic government.

Moreover, the allocation of productive factors under socialism would not need to be by any means perfect to be as good as it is under capitalism. As we have seen, we do not have in most of the economy the perfect competition which must be assumed as the basis for the perfect adjustment of prices and the perfect allocation of productive factors; instead the economy is shot through with monopoly, or is monopolistically competitive throughout almost its entire range. Therefore there is no reason to assume that prices are adjusted and productive factors allocated in such a way as to equate marginal costs, prices, and marginal utility,. and so secure maximum satisfaction. To reach this theoretical ideal, we might have to double our production of aluminum, sulphur, and other monopolized commodities. A socialist government would have a difficult task, but it might make many errors and still do as well as capitalism does.

Many of those who see such tremendous

difficulties in allocation under socialism have a grave misconception as to the present process of allocation. Many of them think that the people want goods, business sets to work to produce the goods wanted, and therefore private enterprise does a fine job in satisfying wants. With respect to some goods this picture is fairly accurate but with respect to others it is badly out of focus. We do indeed want beefsteak or ham or leg of lamb, and the producer does us a good turn in providing it; but we do not in the same way want *saddle* shoes, or *Chesterfield* overcoats, or new styles of women's clothes every six months, or 300 pounds of nickel-plated junk on our cars. The present writer lived for half a century without any conscious yearning for metal trimmings on his car, or a Schick razor, or a key purse, or zippers on his clothing; for generations women led reasonably contented lives without cigarettes or open-toed shoes. To some extent modern industry creates the want which it satisfies; and there is no reason why a socialist government could not do the same thing; or, if it did not devote much energy to the creation of wants, it might allocate the factors of production in such a way as to provide as much consumer satisfaction as we now have, or perhaps even more.

Socialism and human freedom

A far more serious argument against socialism relates to individual freedom. As we noted in an earlier chapter, human freedom as we know it came with the development of capitalism, and there is a clear possibility that it may largely disappear if capitalism is abandoned. It is true that many of the lower and middle classes—laborers, clerks, salespeople, stenographers, bookkeepers and the like—probably have less freedom today than they realize, for their daily routine is largely determined for them. It is probably true that if a people have a deep-rooted love of freedom, as Americans do, and if they develop the social intelligence needed in a socialist regime, as Americans perhaps would not, the masses might well have more freedom under a socialist system than they do in a capitalist economy. Yet the building up of a great government bureaucracy certainly presents a grave danger that the officials might learn to like their power and might decide to perpetuate it by abolishing those periodic nuisances for elected officers, popular elections. The recent steady drift toward absolutism in Europe has emphasized the difficulty of maintaining democratic institutions. Furthermore, a socialist government might introduce various vexatious rules, regulations, and "red tape" into the work and lives of the people, although it might provide more freedom in other respects than capitalism ever did. Presumably it could free laborers from the haunting fear of unemployment, sickness, accident, and old age; but it would mean less freedom for the business rulers and the upper classes in general. As Taussig says: "The abolition of the regime of privilege would necessarily destroy some advantages of the privileged. That elegant freedom now enjoyed by the possessors of large 'unearned' incomes would disappear completely."[11]

In an effort to guard against the dangers of a great government bureaucracy, the guild socialists propose that the unit of the socialist government shall be the "guild"—an association of all the workers in an industry, trade, or profession, corresponding to the *syndicat* of syndicalism. The guild socialists argue that these workers will understand their own industry better than other people can, and will therefore be able to elect competent managers. G. D. H. Cole is the leading figure in guild socialism.

A serious difficulty in the way of socialism as a democratic system would appear in working out the details of the socialist plan to be adopted. Socialists themselves differ more or less on many questions, and there would have to be agreement on these questions. The plan would have to be worked out by fallible men, some of them intelligent, some ignorant, with a diversity of ideas as to details; and the resulting scheme might be a patchwork of compromises and inconsistencies. The plan would have to be approved by the voters, at least in its broad outlines, and would therefore be subject to the pressure of sectional and class interests, as well as to the shifting winds of public opinion. It is one thing to draw up an ideal plan for a socialist society; it is quite another to have it passed in recognizable form by any legislative body, either as a whole or piecemeal. How many wise and laudable measures have been poured into the congressional hopper in Washington, to come out mutilated and unrecognizable!

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[11] *Ibid.*, vol. II, pp. 509–510.

Many people are stubbornly opposed to anything new, except in the realm of gadgets and machines, and quite unable to understand economic and political institutions that they cannot see operating concretely before their eyes, institutions that must be understood from an abstract picture or explanation of what "would be." Many important steps in socialization in this country, such as the reservation of forest, oil, and coal lands, the Tennessee Valley Authority, and some of our great reclamation projects, have been possible not because the people favored them, but because one or more public officials *happened* to get them approved by Congress. Afterward, when the people could *see* "their" forest, oil, and coal reserves as concrete realities, they approved of them; but it would have been difficult if not impossible to persuade them to vote for such projects when they were still in the blueprint stage.

It is one thing, furthermore, to draw up an ideal scheme, such as men of good will and high principles *ought* to like; it might be quite another to administer it to the satisfaction of a public made up heterogeneously of intelligentsia and ignoramuses, workers and drones, altruists and egoists, idealists and "pig-trough philosophers." Even the best possible socialist government might fail to please a great many people. Many reformers have run headlong into the stubborn fact that many of the people don't want reforms, don't want anything better, don't want to be "saved." Jesus was not the only man crucified by the very people He tried to help. Not a few reformers, socialists included, after a few years of hopeful crusading for the "oppressed masses," have come to the conclusion that the oppressed masses apparently don't want to be saved from oppression or, as Mencken once put it, aren't worth saving.

The point of all this is that the establishment and operation of democratic socialism would involve many serious difficulties; and it is at least possible that government officials, even if democratically inclined, might find that the only way to avoid the paralyzing conflicts of interests and opinions, the only way to get things done, would be to take the vote away from the people. To avoid conflicts within the government bureaucracy itself, it might also be necessary to organize a tight party oligarchy which would formulate policies and stamp out all opposition to them. This is what was done in Russia. Marx and Lenin never believed that socialism in its early stages could be operated by vote of the people.

Socialism in a new light

Within the past decade or so, the question of socialism has come up in an entirely new light which gives the socialist argument greater weight. Previously the socialists had argued that socialism would be better than a capitalist system *which worked with fair success;* but today they have a much stronger argument—it would be better than a capitalist system *which cannot be made to work successfully.* We need not as yet close our minds to the real condition of capitalism—whether it is permanently moribund or may some day regain its former vitality. If it does recover and provides jobs and security again, there will be no necessity for shifting to any other system. Many students of the problem are convinced, however, that it will never recover fully, that millions will be unemployed as long as we depend on private enterprise, and that, like Germany, Italy, and Russia, we shall therefore be obliged to shift to another system. Many believe that some form of collectivism—socialism, communism, or Fascism—will inevitably displace capitalism. If this proves true, socialism is preferable to either communism or Fascism, because it is the only democratic form of collectivism.

Partial socialization of our present economy

It may be pointed out, by way of summary, that our economy is already socialized to a greater extent than is commonly realized, and that the trend toward further socialization is very strong, and was so even before the beginning of World War II. The protection of persons and property, always a government function, employs not only the police force and a rapidly growing detective agency—the Federal Bureau of Investigation—but also courts, fire departments, and our armed forces—land, naval, and aerial—including training camps, navy yards, and flying fields. The roads and streets owned by the various units of government represent an investment scarcely second to the amount invested in our railroads, and before the war the investment was increasing rapidly. The post office has been operated by the government since colonial days, but in recent years it has taken on significant additional functions, such as the parcel post and postal savings. The federal government has a fairly heavy investment in waterways, including the Panama Canal, and in harbor and channel improvements; and states and municipalities own certain terminals and wharves. Municipal water departments have taken over more and more of the business of supplying water to cities, until today they provide nearly 90 per cent of this service. Sewage disposal in cities has always been a public function.[12]

In recent years the federal government has intervened extensively in the field of land control and use. We saw earlier that it owns extensive forest, coal, oil shale, and phosphate reserves, a great system of national parks, immense hydroelectric plants and irrigation systems, a vast domain of range lands; and that it is adding to some of these from time to time. The states too have set aside and improved parks and forests. The federal government has gone still further, however, in its land policy, for it has set up agencies to help farmers solve their problems, so many agencies that a good part of the alphabet is necessary to designate them all. It has encouraged and subsidized a tremendous program of erosion control, has undertaken to help farmers move from submarginal to better lands, and has begun a program of providing electric facilities for them. It has undertaken to rebuild the whole Tennessee valley completely, by means of land use control and the development of electric power, among other measures.

Education, once provided by private enterprise or by churches or philanthropists, has become more and more a government responsibility. The government, usually the state or local unit but with increasing federal subvention, assumes charge of the child at the age of six or seven and does not release him until ten or fifteen years later. During these years the state assumes much of the cost of his formal education, and in the earlier years may even provide books, medical inspection, and transportation to and from school. Libraries and museums are generally maintained by government agencies, and have grown in number and importance. Much of the training of research workers and a considerable amount of the research work are done by state universities and departments and by federal bureaus and departments. Our colleges and universities spend 50 millions annually on research, and the federal government, employing some 10,000 workers in its various research agencies, spends about 65 millions.

The federal government has entered various other economic fields to some extent. It not only has made a beginning in slum clearance and the construction of low-cost houses, but has set up agencies to finance home building at reasonable interest rates and to save homes that are too heavily mortgaged. It has an extensive tentative program of slum clearance and low-cost housing to be inaugurated whenever signs of depression and unemployment appear. Similarly in the field of banking and credit, the federal government is intervening in a great many ways. We have seen that it has created a number of lending agencies, in addition to the postal savings banks. In 1938, federal lending agencies held loans amounting to $7,688,100,000 and investments of $2,537,100,000, and the postal savings banks had deposits of more than a billion. In 1945 the latter had increased to 2.5 billions. The federal Reconstruction Finance Corporation, set up in 1932, holds loans of 2.5 billions to banks, railroads, mortgage loan companies, and other business enterprises, and it owns a considerable amount of bank stock. In addition to all this, the federal government through the Federal Deposit Insurance Corporation, guarantees bank deposits up to $5000 per depositor.

The government is increasing its activities in still other fields. It has become active in mortgage insurance, crop insurance, life insurance, accident insurance, unemployment insurance, and old-age pensions, and in providing for health protection, medical services, and recreation and leisure-time activities. Some of these are carried on by the federal government, and some by the state or local unit; in some cases, as in provision of recreational facilities and protection of the public health, all the units of government cooperate.

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[12] See Seba Eldridge and associates, *Development of Collective Enterprise.*

But this is not all. In many other tendencies we can see the steady growth of government functions. The government is steadily whittling down private property rights through *controls* of one kind or another. Although nominally private enterprises, the railroads are closely regulated as to rates, wages, and services rendered; little is left of the concept of private property and private enterprise in this field. Farmers who once did as they pleased with "their own" are now restricted as to the amount of certain crops that they may plant; some of them plant and cultivate on the basis of the advice of government experts in agriculture and erosion control, sell their products under government surveillance, insure their crops with a government agency, use electric power from a government line, borrow from a government lending agency. If they fail in interest payments, they may surrender their farms to the government; if their land is submarginal, the government will move them to a more favorable location. In almost every field of activity the government is reaching out further each decade; at the same time it is taking an increasing share of the returns of private industry through heavier and heavier taxes.

The trend is strongly toward socialism, and there is little basis for hoping that it can be reversed. If the people should vote a conservative administration into power, a few government functions might be abandoned, particularly some of those favored by labor; but no presidential candidate in recent years has dared suggest abandoning much of the New Deal legislation. Alf Landon and Wendell Willkie, Republican candidates for the presidency in 1936 and 1940 respectively, considered it expedient to approve most of it in their campaign speeches, and Thomas Dewey, that party's 1944 candidate, even proposed expansion of the social security provisions. Many critics of the New Deal legislation charge it to President Roosevelt personally and appear to believe that if it had not been for him the country might have run along indefinitely in the good old ways; but there is little truth in this view. The economic ailments from which the country was suffering early in the Great Depression were deep-seated; and they were world-wide, for almost every other country was in similar distress, and the response in many of them resembled our own New Deal program.

We are now in a position somewhere between capitalism and socialism, and it is not certain that it can be maintained long. There is some logic in Arthur Salter's opinion that in such a position we fail to get the advantages of either capitalism or socialism. In some businesses, certainly, the government is interfering so much and so unwisely that it prevents private enterprise from operating with vigor, while the government itself does not take the initiative and go ahead with production under a socialist plan. The result may well be that production cannot be maintained. The success of the Scandinavian countries, whose economy even more clearly lies between capitalism and socialism, indicates that this is not inevitable; but it is not certain that we can duplicate their performance. All in all, the prospect seems to be for a continued advance toward socialism; but if the conservative and reactionary forces of our country are strong enough to stop this trend, we shall turn toward Fascism.

QUESTIONS

1. Define socialism. Which of the following might be privately owned under a socialist regime: a steel mill, a city railway system, a bank, a grocery store, a chain store, a farm, a corporate fruit ranch, a piano, a home, a mortgage, a small hotel in a small town, a large New York hotel, a movie theater?
2. Enumerate some of the wastes of capitalism.
3. Will the jeeps, trucks, radios, etc., used in World War II be brought home and sold to the

people, or will they be sold abroad or given away, in order to keep such articles scarce here?

4. "The existing presumption against any interference with freedom of private enterprise is the most serious hindrance to true economic progress." Argue for and against this statement.
5. What are Marx's important doctrines? Which one stamps him as a revolutionary socialist, or communist?
6. Your textbook has stressed the changing, evolutionary character of our economy. Do you think this is worth while? Why or why not?
7. According to the economic interpretation of history, how could you explain the decline in religious fervor since John Wesley's time? How would you explain the rising divorce rate? The growth of labor unions?
8. Where, at present, do you find anything suggesting a class struggle? Why were wealthy businessmen so hostile to President Roosevelt? What classes supported him, generally, in 1944? Why do wealthy businessmen object to the idea that there is a fundamental conflict between the rich and the poor?
9. Goodwin Watson finds that few unemployed workers become radicals. How can you account for this? Can you explain his conclusion that education is closely correlated with radicalism, that the largest percentage of radicals is found among the most highly educated people?
10. No economic system is good for everyone. For what classes is the capitalist system not very good? For what classes would a socialist system be bad?
11. What were some of the revisionists' criticisms of Marx's doctrines?
12. If a socialist state left the farms, individual retail stores, and small service industries in private hands, might the farmers and small businessmen be hostile to the measures controlling the socialized segment of the economy?
13. How would people save in a socialist economy?
14. If we agree with Carver that a man spends a dollar more intelligently than he casts his vote, must we necessarily be opposed to government action? Why or why not?
15. Discuss the argument that socialism would be less dynamic, less progressive, than capitalism.
16. Might a socialist economy, even with less efficient management than is found in our present economy, be able to produce as much as we do? Where might it be able to save productive energy that is now wasted? What new wastes might it develop?
17. Would the people have to be unselfish under a socialist economy, or would they merely have to be more intelligent than under a capitalist economy? Why?
18. What difficulties might a socialist regime encounter in the management of labor?
19. Would socialism necessarily allocate productive factors to provide less satisfaction than capitalism? Why or why not?
20. Why would it be difficult to operate a socialist system democratically?
21. Under our present system businessmen choose the locations of new enterprises. How would this be determined under socialism?
22. Mention some economic areas which have already been socialized.
23. President Conant, of Harvard University, says we need more radicals in the United States The socialist party is very strong in such countries as Sweden, Norway, Denmark, England, and France, whereas in this country the socialist vote usually runs less than 1 per cent of the total. Does this show a higher public intelligence in this country? Nazi Germany killed or imprisoned her socialist leaders, and our Congress passed a law in 1944 specifically eliminating from the government service three distinguished scholars who were suspected of being socialists. What is the significance of this? Is Nazi Germany a good model to copy in government policies?

Chapter 42.

Communism

Communism defined

In discussing communism we again face the difficulty of clear definition. In the earlier years of the socialist movement the term communism was often used to designate what we now call socialism; and what is commonly called communism today—the system in operation in Russia—is really not communism but state socialism. Strictly defined, communism is *a system in which the government controls not only the socially important capital industries, as in socialism, but consumers' goods as well, and in which there are no differences in the income of the people.* We shall call this utopian communism. Whether the system that Marx advocated—violent revolution of the masses, "liquidation" of propertyholders, dictatorship of the proletariat, and the final classless society—should be called socialism or communism it is difficult to say. The government of Soviet Russia, although it is based on Marxian principles, is not at the present time truly communist, for there are wide differences in income in Russia, and there are some private property and private savings; yet the Soviet government holds as its ideal the truly communist classless society which Marx envisaged as the final state. At any rate, we are obliged to call the Russian scheme communism in order to adapt our discussion to common parlance. We have, then, two kinds of communism, utopian and Marxian.

Utopian Communism

Plato's "Republic"

Utopian communism dates from the great Greek philosopher Plato (427–347 B.C.), whose *Republic* outlined his ideal of a communistic society. The Republic envisaged by Plato was to have "unity," there was to be neither luxury nor poverty, and the soldiers and guardians (rulers) were forbidden to own property. Plato is not clear regarding ownership of property by the other citizens, but at any rate he was opposed to marked inequality of wealth, and in certain passages he seems to favor complete communism. Marriage was to be superseded by community of wives and children, and the children were to be reared by the state; defective children, however, were to be "put away in some mysterious, unknown place" in the interests of eugenics. Community of wives did not suggest any disrespectful attitude toward women, for Plato anticipated modern ideas in according them a higher status than they had in the United States even a century ago. The women were assumed to have the same nature as men, were to be given the same education as men, and were to share in all the duties owed the state, civic and military, although their tasks were to be lighter. Plato's communism was not democratic, for the guardians or rulers were to have rather despotic power, which, as wise and carefully educated men, they were assumed to use for the general good of all. In assuming so much, Plato showed somewhat the same simple naïveté that Marx did more than two thousand years later when he assumed that the proletarian dictators would willingly relinquish their power to usher in the final classless society. As to how his ideal state was to be attained, Plato was indefinite, but he thought that "in heaven, probably, there is a model of it."

Aristotle's arguments against Plato's communism are so shrewd and so modern in tone that they must be reviewed here. Aristotle, the great individualist, began by insisting that "this extreme unification of the state is clearly not good." Common ownership, he insisted, tends to increase the amount of quarreling and dissension: "There is always a difficulty in men living together and havings things in common, but especially in their having common property. The partnerships of fellow-travellers are an example to the point; for they generally fall out by the way and quarrel about any trifle which turns up." As we saw earlier, Aristotle believed that the desire for private property was natural to man. Like modern critics of communism, he brings up the argument later voiced by Malthus: "There is an inconsistency, too, in equalizing the property and not regulating the number of the citizens." He offered a number of arguments against Plato's community of women and his proposal that men and women should do the same kinds of work: "It is absurd to argue, from the analogy of the animals, that men and women should follow the same pursuits; for animals do not have to manage a household." And finally, like most conservatives, he speaks of the lessons of experience: "Let us remember that we should not disregard the experience of ages; in the multitude of years these things [such as Plato proposes], if they were good, would certainly not have been unknown; for almost everything has been found out, although sometimes they are not put together."

Religious utopias

In the centuries following Plato, a number of religious utopias were pictured by dreamers. Jesus Himself, preaching against selfishness, covetousness, and the oppression of the poor by the rich, pictured a coming Kingdom of God, on earth as well as in heaven, that would be founded on love and charity. Some of the early church fathers longed for a better society in which the doctrines of Christianity, rather than the greed of gain, should rule; they dreamed of religious utopias, theocracies governed in accordance with the high principles of Christianity by men who represented God on earth. Most of these early churchmen were concerned with religion and ethics rather than economics. Sir Thomas More's *Utopia*, written nearly two thousand years after Plato, is the first indictment of the religious and economic evils of society of his time; it presents a design for a communist utopia in which there was to be no private property; "and though no man has anything, yet they are all rich; for what can make a man so rich as to lead a serene and cheerful life, free from anxieties; neither apprehending want himself, nor vexed with the endless complaints of his wife?"

Utopian communism in the United States

Far too many communist utopias were outlined after More wrote his *Utopia* to receive attention here; but Fourier, the French communist of the early part of the nineteenth century, demands mention because his work furnished the inspiration for some thirty-four experimental communist societies in the United States, the most famous of which was Brook Farm in Massachusetts, established near Boston in 1840 with the purpose of substituting "a system of brotherly cooperation for one of selfish competition." Some of the most famous writers and intellectuals in the United States—Horace Greeley, Albert Brisbane, Charles A. Dana, Nathaniel Hawthorne, James Russell Lowell, and John Greenleaf Whittier—were interested in this utopian experiment; but it lasted only a few years. Robert Owen, a wealthy English manufacturer who was deeply interested in practical philanthropy and utopias, had established a colony at New Harmony, Indiana, in 1824; but it failed three years later, because equal wages for everyone irrespective of ability or industry did not get the work done. Still earlier than this, in 1787, the Shakers, a sect from England, established a society in New York which was to some extent communist. More than a century later, in 1901, there were seventeen Shaker communities, but they were dying out. Altogether, there have been some fifty more or less communist societies in the United States; but the Amana Society, in Iowa, was the only one which enjoyed sufficient prosperity over a long time to call for careful discussion here.

The Amana Society had its origin in Germany in the early part of the eighteenth century, but their pacifism brought them into conflict with the government, and in 1843 many of them came to the United States and established a thriving settlement in New York. Needing more land, they soon moved to Iowa. Alone among the many communist societies in this country, the Amana Society was reported in 1901 to be prospering; they held some 26,000 acres of land and had seven small villages and several manufacturing industries. The people lived in separate houses but ate in common dining halls, the sexes apart, and all the members received the same allowance for clothing. They lived simply but comfortably, and for many years seemed to find real happiness in their way of life; but in later years they found it increasing difficult to get the work done. Instead of being moved by a deep religious devotion to duty, the young people apparently hungered more and more for the fleshpots of the capitalist Philistines around them. Consequently the Society finally found it necessary to incorporate and to pay labor on the basis of efficiency, whereupon the output of the workmen was approximately doubled.[1]

None of these societies is prospering today. Probably there are valuable lessons in the record. Those that worked best and lasted longest were not democratic but autocratic—perhaps theocratic would describe them better, for religious sentiment was the force that bound the members together—and in the more successful societies one or a few of the older members wielded more or less autocratic power, as representatives of God. Most observers agree that such communities have maintained high moral standards, with little dishonesty, dissipation, or crime; yet there has been considerable complaint of malingering, and a common reason for failure has been the difficulty of maintaining diligence and discipline among the workers. One observer of the Amana Society was convinced that the members were not really happy; that, as Aristotle said, people have a natural desire for personal possessions, and also that the communist life did not permit a good development of personality.[2]

MARXIAN COMMUNISM

Far more important than utopian communism is the Marxian brand that has caused property-owning classes so much loss of sleep in recent years. Marx's doctrines that are not incompatible with democratic socialism have been considered in the preceding chapter. In the present chapter we shall consider Marx as the protagonist of the violent revolution and the dictatorship of the proletariat, the "patron saint" of the Russian Revolution and of revolutionary classes throughout the world. It is in these roles that he has been anathematized by aristocrats, capitalists, and defenders of the capitalist system over the entire world. As long as socialists advocated the establishment of their society by democratic and peaceful persuasion and without violence to capitalist leaders, or merely drew dream pictures of utopias without indicating how they were to be realized, they roused no serious alarm; but when Marx raised the flag of revolution and threatened the "forcible overthrow of all existing social conditions," the seeds of class war were in the soil, a class war which has been carried on with savage ferocity by both parties to it.

The average student of economics finds it difficult to understand the reverence in which Marx is held by communists. Marx has only a small following in the United States, but in some European countries he is worshiped almost as a saint by millions of proletarians and communist leaders, and his words are studied with almost the same reverence that devout Christians give the Bible—all this in spite of the fact that much of what he wrote is so foggy in thought and so labored in exposition that only a very patient and industrious man can follow it. There are probably not a dozen economists in the United States who have read all of Marx's *Capital,* to say nothing of the rest of his works. Yet this dreary, unreadable book is the bible of millions of laborers, and of some brilliant and well-educated leaders of the communist movement as well; such leaders as Lenin, Trotsky, and Stalin studied his works with much care, and referred to them as the fountainhead of all economic truth. It would be a far graver offense to question the validity of Marx's doctrines in Russia than to question the authenticity of the Bible in America. In communist circles, a pat reference to Marx is enough to clinch any argument.

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[1] See U. S. Department of Labor, *Cooperative Communities,* Bulletin 35.

[2] Millard Rice, "Eighty-Nine Years of Collective Living," *Harper's Magazine,* October, 1938, p. 522.

Theory of the violent revolution

It is important that we understand clearly why Marx thought the violent revolution necessary and inevitable. Marx looked upon society as composed of "oppressors and oppressed." He saw no hope that labor could ever achieve its socialist goal by peaceful means, for no ruling class in history ever surrendered its power without a struggle. His strategy consisted in strengthening the economic and political power of labor, in preparing it for what he looked upon as the inevitable revolution. Some communists hold so strongly to the theory of the revolution that they oppose most measures designed to ameliorate the condition of labor by "patching up the rotten old capitalist system" —as a communist once expressed it to the writer—because they regard all palliatives as delaying the inevitable revolution. Here they come into conflict with socialists, who believe in a gradual and peaceful transition to socialism. Many ill-informed people consider socialists and communists as birds of a feather; and when the entire radical movement is endangered, the two groups do sometimes unite for mutual protection; thus when France was threatened with Fascism, the communists united with the socialists in what was called the Peoples' Front. Generally, however, communists regard with hostility and contempt the socialists' love of democracy and hope of peaceful socialization, and sometimes try to break up their meetings.

Revolution not necessary. Marx's advocacy of revolution runs so strongly counter to American feeling that it is hardly necessary to discuss it; yet a few criticisms may be offered. The claim that it is impossible to improve the condition of labor by peaceable and democratic procedure is invalid, as the history of labor legislation in every civilized country during the past hundred years clearly proves. If socialism is deemed necessary to the welfare of labor, the steady advance of socialization suggests that even this may not prove to be impossible. It is indeed true that what Marx calls the "ruling class," with its large measure of control of the press, the radio, and education, is in a powerful position, and that it has been able to put up a strong fight against such measures as it has opposed, and, except in Russia, has been able to defeat every effort of labor to capture the citadels of ultimate power. Nevertheless, labor has made great advances since the time, only a century and a half ago, when unions were prohibited, and since the time, less than a century ago, when women in England were hitched to carts like animals to haul coal out of the mines.

Probable failure of the revolution. But Marx was not very realistic in another respect. In his conviction that the revolution would ultimately bring victory for the proletariat, he gravely underestimated the power of the ruling class and the loyalty it would command from the middle classes (which he wrongly assumed would practically disappear). He foresaw the ruling class—the capitalists or bourgeoisie—as a small group overthrown by the masses of organized proletarians; but the fact is that in every attempted revolution, except that in Russia, the capitalists have been supported by most of the middle classes— farmers, small merchants, and clerical workers—by the government employees, and by the army and navy. It is impossible to predict what may happen in future revolutions, but up to the present the only successful revolution has been that in Russia; and that was successful only because of a combination of peculiar circumstances which would rarely appear again. When the Bolsheviks seized power, Russia was in almost complete chaos; her people were starving and hopeless, and angered at their betrayal by traitors high in the government service; her army, defeated and hungry, was no longer loyal to the government; and the machinery of government had broken down.

Such a situation is most likely to develop at the close of a disastrous war, but it is unlikely even then. Even if the middle classes turned against the government, the army and navy, which are usually well provided for, whatever the condition of the people generally, would seldom swing over to a revolutionary movement, for such a step is contrary to all the traditions of military life. Ther have been exceptions—as when, during the French Revolution, part of the Army turned against the established government, and when the Russian Army supported the Bolsheviks during the revolution—but such cases are very rare. In the United States, as in most countries, the Army and Navy are traditionally conservative, and many officers are closely allied with wealthy capitalist families by marriage or otherwise. It is therefore almost inconceivable that any branch of our armed forces would support a revolution, and their opposition would mean its inevitable defeat.[3]

What gain from a revolution? Suppose we assume, however, that a revolution is successful. What chance is there that the general good will be served, that out of the revolution and the ensuing dictatorship of the proletariat will come a better society than we now have? Marxians have always regarded the capitalist class as the arch-enemy of the masses, and have assumed that if these "exploiters" were out of the way a fine "classless" democratic society could be built up. After winning the revolution and killing all the leading bourgeoisie and aristocrats, the communist "comrades" would be miraculously transformed into idealistic gentlemen genuinely interested in building a humane democracy. Such an assumption, however, seems hardly reasonable; for the hatred and brutality engendered in the revolution would persist afterward, and the end might thus be lost in the means. As the history of the Stalin regime in Russia suggests, the men who so cheerfully plot the "liquidation" of their adversaries are likely to try out this technique on each other—at any rate, except Stalin, all the Bolshevik leaders who engineered the Russian Revolution in 1917 are now dead. The philosophy of violence looks much like the surrender of civilization itself. Harold Laski has expressed this well: "It is difficult to see that a regime which, like that of a proletarian dictatorship, is avowedly built on the use of hatred and fear and calculated relentlessness can give birth to a society distinguished by fraternity. . . . The cost, in a word, of applying the Marxian formula of conflict may well be the impossibility of attaining the ends that Marx himself had in view."[4]

Dictatorship of the proletariat

Marx was hazy about the dictatorship of the proletariat which it was assumed would follow the revolution, but he apparently believed that it would be only temporary, that the leaders who had brought the revolution to a successful end would soon surrender their power to the liberated proletarians, who would thereupon enjoy a fine form of democracy in the new "classless society." It seems altogether unlikely, however, that any dictator, particularly the type that rises to the top in a regime of violence and murder, would willingly surrender his power and become one of the masses in a classless society. Love of power is strong in some men, and it is likely to be especially strong in the type of man who leads a revolution.

The experience of Russia indicates that the proletarian dictatorship is likely to be a tyranny as harsh as the one it replaces. Whatever good may be said of the Soviet regime, it has in some respects been autocratic and brutal. Marx assumed that the dictatorship would be administered in the interests of all; but it is difficult to see how this would be possible, for, as Laski has pointed out: "No dictatorship can ever fully respond to the wants of men except when those wants are freely announced; and it is, after all, the declared purpose of the dictatorship to prevent such announcement by suppressing the views and movements alien from its own conception of what men ought to want."[5]

Marxian communism and religion

Bound up with their theories of class war and violent revolution is the communists' hostility to organized religion, which Marx called the "opiate of the people." Communists believe that religion is designed to divert the people's attention to the future life and away from the injustices of their present life, and therefore to stifle their interest in efforts to improve their present condition. For such a country as Russia before the revolution, there was much truth in this view, for the Russian church was really an arm of the government, working to keep the masses ignorant, docile, obedient, and content with their servile condition. Religion has the effect everywhere of keeping the people content with their condition, but whether this is to be considered an evil is a question on which there may well be a difference of opinion. Those who regard revolutions as likely to improve the lot of the people will regard religion with little favor.

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[3] One of the best analyses of this point is to be found in Harold Laski's *Democracy in Crisis.*

[4] Harry W. Laidler and Norman Thomas (eds.), *The Socialism of Our Times, a Symposium*, p. 99.

[5] *Ibid.*, p. 101.

The classless society

The final classless society apparently means merely a society in which there is not the present division into rich, middle class, and poor. Marx seems to have believed that this would be possible because goods would be so plentiful in the socialist state that their distribution could be effected without any serious conflicts of rights such as characterize the scarcity economy of capitalism. Engels expresses this theory more clearly than Marx did: "When, together with class domination and the struggle for individual existence created by the present anarchy in production, those conflicts and excesses which result from this struggle disappear, from that time on there will be nothing to suppress, and there will be no need for a special instrument of oppression, the state."[6] Marx was not the only radical to assume that goods would be so plentiful as to be practically "free" in the socialist state; this belief is held by some socialists as well as communists.

The poverty of Russia after more than twenty years of communism might lead us to think such a notion utterly fantastic, as indeed it is; but it must be conceded that Russia is hardly a fair criterion by which to judge Marx's ideas. Marx always believed that communism would appear first in the industrially advanced and efficient countries in which technological methods were capable of abundant production of goods. Only in such countries, according to him, was the proletariat important enough to achieve success in the revolution. This view proved erroneous, for the revolution appeared first in Russia, a poor country that was not at all advanced industrially. Therefore, instead of taking over a highly productive industrialized nation, the new government was obliged to start almost from scratch; the industrial equipment was poor, there were few competent technicians, labor was generally inefficient and unskilled, the people were starving, and, most important of all, the country's whole economy was in utter chaos as the result of the First World War. Furthermore, the Bolshevik government had to impose its new order in a country the vast bulk of whose people were peasants, acquisitive, individualistic, and therefore naturally hostile to communism.

Even in an industrially advanced country, however, the economy could hardly be so productive under communism as to eliminate conflicts over rights to goods. Moreover, it is impossible to conceive of a classless society in which there would be no need of state control; and there might well be more conflict and dissension than there is under capitalism.

For yet another reason the classless society looks like a mirage. The government bureaucracy would be very powerful, and it would almost certainly treat its members well, as the record of the Soviet government clearly indicates. The Russian government has tried to guard against this by setting the limit for salaries of party officials at a low figure—about $150 a month—but with their complete control over the economy and the treasury these men can get about anything they want without paying out any of their own salaries, and many of them treat themselves very well. Whether the communist society is dominated by an autocratic dictator or by a more democratic group, the huge government bureaucracy might constitute a new ruling class, perhaps as selfish and ruthless as the capitalists it displaced.

THE SOVIET REGIME

Difficulties of appraisal

Turning from the consideration of Marx's theoretical doctrines to a study of the practical application of some of them in Soviet Russia, we face another very difficult task. A vast human upheaval such as Russia went through has so many different aspects, so many varied implications, that it can be fully understood only by superhuman intelligence; and to this the present writer lays no claim. There are various reasons for this difficulty in understanding. In the first place, the Revolution of 1917 which ushered in the Bolshevik regime was the culmination of historical developments extending back two centuries. In the second place, the rise to power of this regime, and its virtues and vices, can be understood only by reference to the peculiar characteristics of the Russian people and of the Russian economy. In the third place, the attitude of the observers of this great social experiment is always colored by their own conception of values, with the result that different writers, even when they see somewhat the same facts and conditions, come to quite different conclusions as to the real character of the Soviet regime and as to its success or failure. In the fourth place, Russia is so vast that conditions vary widely from one part of the country to another; consequently reports regarding conditions are often so contradictory as to leave the reader utterly bewildered. In the fifth place, like most totalitarian governments—and, for that matter, like other governments as well—the Soviet regime has often tried to conceal its mistakes and failures from the outside world, has apparently doctored statistics occasionally to make conditions appear better than they really are, and has "shown visitors around" in escorted tours which give them too rosy a notion of what is going on; while, on the other hand, many newspapers and public officials in capitalist countries have deliberately pictured conditions as worse than they really are.

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[6] Quoted in Leon Trotsky, *The Revolution Betrayed*, p. 52.

Russia before the Revolution

The Bolshevik Revolution of 1917 was to some extent the result of historical developments that dated at least from the time of Peter the Great. The population of Russia in the late seventeenth century was a vast, stagnant mass of poverty-stricken, illiterate, superstitious serfs, ruled by an all-powerful czar with the aid of a state-supported church which, like the serfs, had changed little since feudal times. Peter was ambitious and worked hard to modernize the government, the army, and the courts of Russia to make them conform with the standards of other European countries, and he did a great deal to encourage trade and industry; but his efforts at modernization failed to include the church and the peasants. During the next century western European ideas spread to the aristocracy in St. Petersburg, and a fairly high culture developed there; but the abject poverty and degradation of the serfs remained unchanged. Thus the government and the aristocracy were separated by a wide gulf from the masses of the people. As one of the results of this condition, Pugachev's rebellion, about the time of our Revolutionary War, spread over much of southeastern Russia and threatened to overthrow the government, but was finally suppressed after unspeakable atrocities and much bloodshed.

During the nineteenth century the situation changed somewhat, but not in the direction of stability. Partly as a result of the French Revolution and the Napoleonic Wars, and partly from other causes, the western European governments moved toward greater democracy and freedom, but the Russian government did not keep pace. It remained a semi-feudal autocracy. In the meantime a class of writers and intellectuals, of whom Tolstoy and Dostoevski were among the best known, grew up in Russia, some of them radical in their social views, some of them even active conspirators, and many of them sympathetic with the serfs. Serfdom was abolished in 1861, but the peasants gained little because they were now burdened with heavy annual payments on their land. After 1880, rapid industrialization and urban growth went on, aided by French, Belgian, British, and German investments; and this led to the appearance of a fairly large working class. But agriculture remained stagnant, and the peasants were persistently hostile to the government. The Czar was supported only by the nobility and the higher clergy, both largely incompetent and corrupt. The weakness and corruption of the government were clearly brought out by Russia's defeat by Japan in 1904. Along with many other factors, this defeat—a great surprise to the Russians themselves as to many others throughout the world—gave rise to a wave of public unrest that was marked by demands for a more liberal government and greater freedom for the people, and culminated in the revolution of 1905.

On "Bloody Sunday"—January 9, 1905—thousands of unarmed workers under the leadership of Father Gapon marched to the Czar's Winter Palace to present a petition for reforms and were wantonly fired upon by the Czar's troops, who killed or wounded 1500 men, women, and children. This, and the accumulated grievances of many years of misrule, led to other uprisings of peasants and workers in many parts of Russia in which thousands were killed and no less than 180,000 were exiled, mostly to Siberia; more than 70,000 revolutionists are estimated to have been in jail at one time. On the face of it, the revolution of 1905 failed, but it was really a rehearsal for a later revolution which was to be successful.

During the years after the 1905 revolution, Russia's political and economic situation was highly unstable. The government, always despotic and honeycombed with graft and incompetency, followed a policy of brutal repression in its efforts to hold in submission the vast population of poor peasants and workers, and at the same time adopted an expensive foreign policy calling for national aggrandizement. Politically the government was top-heavy, and the country's economic structure was similarly top-heavy. At the top of the economic pyramid were the huge industrial plants that had been built up with the aid of government subsidies and foreign capital; at the base there were millions of ignorant and tradition-bound peasants who carried on a primitive agriculture with methods little more advanced than those of the Middle Ages. Most industrial workmen were unskilled and indifferent, and unequal to the demands of modern industrial techniques, and the managers were likewise generally incompetent. The economy was unbalanced in other important respects as well, particularly in the lack of adequate railroad facilities and good highways.

The Revolution and the Provisional Government

The First World War brought out all the rottenness and inefficiency of the Czar's regime, and all the fundamental weaknesses of the Russian economy. Nicholas II was a weak sovereign, and most of the ministers with whom he surrounded himself were lazy and incompetent; some were dishonest and a few were disloyal. One of the highest officials in the War Office was a traitor in Germany's employ; soldiers were sent into battle without adequate arms or entirely unarmed; cartridges were given them which did not fit the rifles; incompetent generals sacrificed millions of men in badly planned campaigns; and machine gunners behind the Russian lines were ordered to shoot any soldiers who tried to escape from the mass murder of unequal battle with the Germans. After two or three years of war, the peasants and workmen at home suffered from insufficient food and inadequate clothing. By the winter of 1916 the growing economic chaos and the successive military defeats had so thoroughly disheartened the people that they revolted in February, 1917. Although the revolution had no definite leadership, it was so far-reaching that it overthrew the government, which by now lacked even the support of the army. A provisional government headed by Prince Lvov was set up, and Miliukov and Kerensky were given important posts. Within a few months Kerensky became Prime Minister of Russia.

The leaders of the Provisional Government believed that under their more democratic regime Russia would resume war; Allied agents working to achieve this end were also active inside the country. Kerensky finally persuaded the army to resume the offensive, but the offensive collapsed in two weeks and the army began to disband.

On two points the Provisional Government failed to meet the demands of the people: It tried to resume the war, and the people would have no more of it, and it failed to meet the peasants' demand for a distribution of the large landed estates. This government was not very radical but was merely attempting to establish some form of democratic regime. The people on the other hand—the workmen and the peasants—were moving rapidly to the left. The government finally drew up a law providing for the socialization of agricultural land, but this was dropped when France and England objected to it as likely to interfere with the vigorous prosecution of the war. This sealed the fate of the Provisional Government.

Bolshevik control

The Bolsheviks, a Marxist party headed by Lenin, had been working among the discontented masses since 1903. A shrewd strategist with an astute understanding of the psychology of the Russian people, Lenin had gathered around him a small group of trained revolutionaries who were prepared to seize power whenever the opportunity arose; and he saw this opportunity when the Provisional Government lost the confidence of the people. He and Trotsky seized control of the army at Petrograd (now Leningrad), and on October 25, 1917, overthrew the government and set up a government of the "soviets of workers', soldiers', and peasants' deputies." The new government announced four major policies: immediate peace, immediate distribution of the land, (some of it had already been seized by the peasants), control of industry by the workers, and self-determination for all non-Russian peoples in the country. A number of national groups—the Finns and Ukrainians, for instance —had seceded from Russia during the Provisional Government's regime, and that government had tried to force them to rejoin Russia. Lenin insisted that they should be allowed to determine their own destinies.

The radical policies of the Bolsheviks naturally aroused the opposition of certain other classes. That the aristocracy and the bourgeoisie should be hostile was to be expected; but the Mensheviks and Socialist Revolutionaries, who may be described as more moderate socialists, were also generally opposed to so radical a program. Many of the intellectuals who had at first welcomed the Revolution were alarmed by the extremes to which the Bolsheviks proceeded, and turned to an attitude of hostility. Furthermore, foreign agents were constantly working to overthrow the new regime.

Peace negotiations were begun with Germany. The Bolsheviks believed, rightly, that the World War was an imperialist struggle and believed, wrongly, that the proletariats of other countries would revolt and force all the nations to end the war. The Soviet congress urged an immediate peace based on the general principles of no annexations or indemnities and of national self-determination, but the Treaty of Brest-Litovsk imposed by Germany was a conqueror's peace. It divested Russia of Poland, the Baltic provinces, and the Ukraine, the latter a rich agricultural, mineral, and industrial region which Germany was later forced to give up by the Versailles Treaty. With the army disrupted and the Russian economy in chaos, Lenin was obliged to accept these peace terms.

After moving the nation's capital from Petrograd to Moscow, the Bolsheviks proceeded to set up the new government. They took over banks, insurance companies, large industries, mines, and rail and water transportation facilities; they repudiated all foreign debts incurred by the Czar and the Provisional Government, confiscated all foreign industrial investments in Russia, and declared foreign trade to be a state monopoly. Such policies of course stirred up a counterrevolution on the part of the dispossessed classes in Russia, as well as foreign nations. The Bolshevik government, struggling to bring order out of the postwar chaos, was thus forced almost immediately to wage war on every front; and the result was widespread starvation and destitution such as the world has seldom seen.

The opposition of the other nations and of the White Russians (the aristocrats) tended, in a way, to strengthen the Bolshevik government by cementing the loyalty of the workmen and peasants. From every direction foreign nations, alarmed by this threat to their capitalist institutions, invaded Russia to destroy the Bolshevik regime. German and Austrian troops took over the Ukraine and assisted White armies in the Caucasus; Czech forces operated in the Ural Mountains and in Siberia, with help from Japanese troops in eastern Siberia; British, French, and American forces invaded from the north; counterrevolutionary troops in southern Russia advanced northward under a succession of generals; Admiral Kolchak led an army of Whites in Siberia and set up a new government there. Thousands of soldiers and civilians were killed, and vast areas were laid waste by the ravaging armies. The war, like most class wars, was waged with ruthless cruelty on both sides. For a while the position of the Bolshevik government seemed desperate, for it was largely cut off from food, coal, oil, and other war essentials; but it eventually achieved complete success because Trotsky's Red Army was fanatically devoted to the cause and had the support of the masses of the people.

The defeat of the White and foreign armies in 1920 put the Bolshevik government firmly in the saddle. It was obliged, however, to abandon hope of immediate world revolution, for the Third International, an international organization set by up by Lenin to foment and direct the expected revolution in other countries, met with little success. Later the Bolsheviks engineered communist revolutions in Hungary and Bavaria, but both were promptly suppressed—in Hungary, with savage brutality on the part of both communists and Whites. Through its principle of complete equality of nationalities the Bolshevik government won friends in the Orient, particularly in China, where communism spread into some of the provinces but did not win over the Chinese government.

As a result of six years of the World War and civil war, the Bolshevik regime faced a desperate situation, with several million young men killed and other millions wounded, with factories in a state of decay, property destroyed, railroads in disrepair, raw materials scarce, and the people hungry. A drought caused a famine in the Volga region in 1921; and millions starved to death or died of diseases resulting from insufficient food.[7]

The New Economic Policy

During the civil war, the government had followed a policy of "war communism," which involved rigid discipline for everyone; but in the face of the catastrophic famine in 1921, Lenin wisely decided that the people needed a breathing spell from communism and that a more liberal policy should be followed for a while. He persuaded the party to adopt the New Economic Policy (NEP), under which farmers, instead of turning all their surplus grain over to the government, were assessed a fixed grain tax and were allowed to sell their surplus in the open market. Big business remained in the hands of the government, but small business was reopened to private enterprise. As a result, some small private business enterprises appeared, and a new class of fairly prosperous farmers, the kulaks, sprang up. During this period the government tightened the iron discipline within the party and worked out plans for the continued expansion of the national economy.

The death of Lenin in 1924 added seriously to the difficulties in the way of the new regime. Lenin had shown great practical sagacity in many crises, and he had the affection, amounting to adoration, of the people. Had he lived, communism might have fared better than it did under his successor. His death was followed by a bitter struggle between Trotsky and Stalin, the two candidates for the office of party head. Trotsky, the logical successor, was a brilliant intellectual, the foremost theorist in the party, co-worker with Lenin in the Revolution, and head of the Red Army. Stalin, although not an intellectual, was energetic and practical-minded, and an astute politician. The two differed in their views on important questions. Thus Trotsky demanded vigorous action against the kulaks, whom he regarded as a discordant element in a communist society, whereas Stalin favored less drastic treatment, although later he liquidated them without mercy. Trotsky, like Lenin, believed that communism could not be achieved in Russia alone, and that therefore the party must work hard to bring about the revolution in other countries; Stalin saw no immediate hope of revolution abroad, and thought that Russia would have to proceed alone and build up a powerful defense against possible foreign aggression. Stalin controlled the party machine, and, using tactics worthy of any Tammany Hall boss, he secured the place. Trotsky sought exile first in Turkey and later in Mexico, where he continued his vigorous opposition to Stalin's policies until his death, in 1940, at the hands of an assassin.

Although Russia was making fairly good progress under the NEP, this policy was abandoned in 1928 and the Soviet government, under Stalin's leadership, returned to its former relentless policy of socialization, of striving to build up the nation's industry and agriculture and to foster communism among the people. Its efforts to build up Russian industry called for the export of as much goods as possible—even to the point of reducing the people to hunger—in order to secure imports of tools and machines. Agriculture was collectivized, and new plants were built for the manufacture of tractors for the collectivized farms. Kulaks who refused to cooperate cheerfully were loaded into box cars and shipped by the hundreds of thousands to Siberia, or forced to work like slaves on public improvements. In an effort to speed up production, Stalin in 1931 introduced a system of piecework, graduated wages, and wage bonuses.

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[7] For an account of this catastrophe, see Anna Louise Strong, *I Change Worlds*.

In its treatment of the peasants, the government revealed a cold and ruthless brutality which can be condoned, if it can be condoned, only on the ground that it was necessary to the achievement of genuinely worth-while objectives. Not only were the kulaks driven from their homes and their property confiscated, but high taxes were levied on all the peasants. When the peasants resisted these taxes in 1931 and 1932 by refusing to harvest more than they needed for their own use, the government appropriated all they had harvested and left them to get on as best they could. According to some reports, several million people starved, but this may be an exaggeration.

Why was it necessary to press the collectivizing of the farms so relentlessly, at such a cost in human suffering? Several reasons are advanced. In the first place, the Russian peasants, using the most primitive methods, were barely able to feed themselves, inadequately, in most years; and if the government was to build up great industries in the cities, it needed enough food to feed large urban populations. Peasant landholdings were small; those in the Ukraine were among the smallest anywhere in Europe. Furthermore, the land was cut up into numerous small strips, sometimes miles apart, which had to be cultivated with primitive farm equipment, in some cases with a wooden stick instead of a plow, and without even an ox or horse. Harvesting was generally done with a sickle, threshing with a flail; and with little fertilizing or rotation of crops, yields were generally poor. In the second place, the poverty-stricken, individualistic peasants were an anachronism in a socialist state; and in the third place a good life and a high culture could not be built up on farms operated by such peasants. The kulaks themselves were "rich" only in comparison with the desperately poor mujiks; and the kulaks were said to oppress the poorer peasants cruelly as usurers and employers of labor. Their "liquidation" was sometimes demanded by the mujiks as well as by the government.

The Russian economy

To describe the operation of communist Russia's government and economy is a difficult task; nevertheless we must try to point out a few of the most important characteristics of this great economic experiment. Russia, with one-sixth of the land area of the earth, is the largest single country in the world, although the British Empire, including colonies, is larger; Russia's resources are greater than those of any other country, with the possible exception of the United States; and her population, nearly 200,000,000 before the Second World War, was much the largest of any country in Europe, and this it is still, although some millions were killed in battle, or died from starvation and cold, or were murdered by the Germans. Estimates of the total deaths run as high as 30 or even 40 millions.

The Union of Soviet Socialist Republics (U.S.S.R.), as Russia is now called, is a voluntary federation of sixteen republics, each of which, as in the United States, has certain local powers. The All-Union Congress of the U.S.S.R., composed of delegates from every part of the union, is the supreme governing body; it meets only every two years. The permanent central governing body operating between sessions of the Congress is the Central Executive Committee; however, it delegates to the Council of People's Commissars (Sovnarkom) the function of directing most of the government's work. This Council is composed of some 15 commissars, who head such departments as foreign affairs, defense, foreign trade, communication, heavy industries, river transport, mail and telegraph and radio, forestry and wood industries, light industries, agriculture, state farms, food industry, internal trade, finance, and internal affairs. A few other departments are not represented by commissars; one of the most important of these is the State Planning Commission, or Gosplan, which controls the planning of the nation's production and distribution. Local affairs are left to the local Soviets, which have as much power as the central authorities see fit to give them.

The Gosplan

In a capitalist economy we depend on the profit-seeking entrepreneur to manage production, guided by relative prices and costs as to what and how much he shall produce; but in the Soviet economy much of this is done by the government—by the Supreme Economic

Council working through the Council of People's Commissars and the State Planning Commission, the Gosplan. The end sought is of course not profit but the building up of the nation's productive wealth and the satisfaction of the people's wants, or what the government conceives those wants to be.

The Gosplan is a vast and complex organization that assembles mountains of figures on practically everything—the amount of land, labor, capital equipment—throughout the U.S.S.R.; an army of accountants and statisticians sifts and correlates the mass of information that continually pours into its offices. On the basis of such data, and in cooperation with certain other branches of the government, the Gosplan draws up a tentative plan for the production of various commodities throughout the economy for a five-year period. This plan is turned over for detailed consideration to the various enterprises and organizations that are concerned; it is then returned, with suggestions, to the Gosplan, which, after further work on it, issues the final plan. Although the plan covers a period of five years, it is subject to change from time to time as conditions change; thus, in the past, each plan has called for a rapid increase in production, but in some cases it has had to be modified because the goal set for some commodities has been achieved in less than five years, whereas the goal set for others has had to be extended.

Apportionment of productive factors. How does the Gosplan apportion productive factors among the various industries? How does it determine the relative amounts of different goods that shall be produced? In a capitalist economy, as we have seen, the allocation of productive factors is determined by relative prices. When consumers want more of any given commodity, they bid up the price, and the profit-motivated entrepreneurs set themselves to work to produce it: when consumers want less of anything, they buy less, the price declines, and the entrepreneurs shift to the production of other goods. How does the Gosplan secure this adjustment of production to the wants of consumers?

In the first place, the Soviet government is not exclusively interested in providing present consumer satisfactions. At times the people have been obliged to live on a diet little above the subsistence level, clothing has been scarce and poor, and many comfort goods entirely lacking. The government has deliberately skimped consumers' goods in order to build up productive capital as rapidly as possible so that consumers' goods may be more abundant in the future. In the second place, to the extent that consumers' goods are produced, the relative amounts of each are to some extent determined in a sort of "market," not the market of a capitalist society, yet perhaps not much inferior in its capacity to indicate consumer choices. Contrary to a rather common notion, the Soviet economy is not simply a giant state enterprise, hiring all the labor, producing all the goods, and dividing all the products according to its own whims. It is not so simple. The state does not hire all the labor or produce all the goods. State, regional, and municipal enterprises do produce practically all the new capital goods—factories, tractors, and the like—and some, but not all, consumers' goods, including farm products. Producers' cooperatives, on the collective, cooperative farms, produce most of the farm products—"state" farms, operated directly by the Soviet government, produce less than 10 per cent—and cooperative urban shops or "artels" and individual producers turn out a small amount of some consumers' goods and services. Thus the supply of many goods comes from a number of different sources. This is likewise true on the demand side, for government representatives buy some goods for various state institutions and uses; consumers' cooperatives, somewhat like those of other European countries, buy some things: and the consumers themselves purchase various types of goods. Goods that consumers prefer soon disappear from the retailers' shelves, whereas goods that are not in such great demand may have to be reduced in price. There is a rather complex interlacing of demand and supply in the Russian market, and Soviet leaders insist that this is necessary to the success of their system.

The Communist party

What of the Communist party in the organization of the government? Apparently it has no direct legal authority whatever, no organic connection with the Soviet government. Party membership, which runs to nearly 3 million, is a privilege and an honor accorded only to those who maintain unquestioning loyalty to the communist creed as formulated by Marx and interpreted by Lenin and Stalin, and to those who are active and zealous in the public interest, who do any task assigned them with efficiency and expedition, and who pay the party's rather heavy dues regularly. Honor and hard work are apparently the only reward of party membership. Two organizations for children, somewhat like the old Hitler Youth in Germany, train the young for later membership in the Communist party—the Octobrists, for children between 8 and 10 years of age, and the Pioneers, for children from 10 to 16 years old. Training in the communist dogma begins very early in life.

The major function of the Communist party is to train leaders for government posts. In addition, the members serve as unofficial industrial "shock troops" in the factories, where they are engaged in building up morale and aiding in the solution of management and production problems.

Collective farms

For the first few years, collective farms were managed on a really communist basis, all the members working somewhat as they pleased, and sharing the produce, above taxes, on the basis of the number of mouths to be fed. This did not work well, and a more businesslike system was evolved, under which brigades of workers were assigned to each task, and wages were proportioned to the amount and laboriousness of the work done. As has been said, each worker may own his house, a patch of land, and some poultry and livestock. If at the end of the season there is a surplus of earnings above living requirements, the members of the cooperative meet and decide how much of it shall be devoted to capital improvements—a cattle barn, a silo, a clubhouse, or some other addition—and how much shall be distributed among the members in money or produce. Coordinated with the collective farms is a vast organization of tractor stations, whose function is to keep the machines in working order. Management and efficiency vary greatly among the collective farms, and some have been far more successful than others; but most competent observers believe that after about 1935 the output of these farms was much greater than peasant agriculture had been able to produce; production just before the Second World War was estimated to be about twice the amount that was produced in 1913. This increase is due to mechanization, the greater use of modern science in agriculture, and perhaps to generally higher intelligence among the farmers themselves.

Retail distribution

Retail distribution, like production, is handled by a number of different kinds of agencies. Most of the retail business—some 70 per cent of the total in 1935—is done by consumers' cooperatives; but the pattern of retailing, like many other things in Russia, is constantly changing. There is an increasing number of shops, operated either by the central government or by local authorities, that sell the products of various state manufacturing "trusts." Some time ago the government formulated plans for "one-price" stores after the model of the Woolworth stores of some years ago. There is considerable variation not only in the types of stores but in the services they offer, such as delivery of purchases.

Soviet finance

Money. The Soviet monetary system, once a headache to students of economics, has been simplified in recent years. For a time after the Revolution the government tried to get along without any money; when this proved impossible, it turned to paper money but printed it in such vast quantities that a disastrous inflation followed, culminating in 1924. The government then instituted a monetary system based on a new ruble, but this system is too complicated to be discussed here. At present the U.S.S.R.'s monetary system somewhat resembles our own, in that it is based on a "managed" currency of inconvertible ruble notes and subsidiary coins; however, Russia does not have tremendous gold reserves. Since the government determines to some extent the production of most kinds of goods and exercises some control over prices, money does not serve quite the same functions that it does in a capitalist economy; variations in the quantity of money, for instance, do not affect prices as much as they do in our own economy.

Banking, insurance, and foreign trade. Banking is a state monopoly in the hands of the Gosbank and the State Savings Bank. The Gosbank, with some 2000 branches throughout the country, carries the accounts of the various state enterprises; and the Savings Bank, with 20,000 branches, handles the people's savings, paying a generally high rate of interest. These savings deposits are invested in government bonds and are exempt from most taxes. The Soviet government appears anxious to encourage thrift, perhaps for the purpose of keeping down the demand for goods which have always been rather scarce.

Insurance and foreign trade are both state monopolies. Insurance is compulsory on some forms of property and optional on others; life insurance is optional. Foreign trade is under the administration of the People's Commissar of Foreign Trade.

Government revenues. Students of economics may well wonder where the Soviet government gets the vast revenues needed to run its great bureaucracy, support the largest army on earth, and build immense factories and other productive plants. In general, there are two sources of revenue. By far the more important of the two is the net receipts of the various government enterprises, some of whose products sell at prices above cost of production and so yield a profit to the government. This really amounts to a tax on the buyers of these products. The other important source of revenues is taxation. The plan of taxation resembles that used in capitalist states, but has the twofold purpose of penalizing any remnants of private profit-making enterprise that may still exist, and of building up the socialist state. There are a few direct taxes: one on the output of industrial enterprises—a sort of sales tax—and one on all agricultural enterprises levied on the basis of the size or importance of the various enterprises. Both of these taxes are so adjusted as to favor collectivized concerns and any others that the state may wish to encourage. There is also a complicated income tax, the rates of which vary not only with income but with the various categories into which the people are classified. Finally, there are excise taxes on alcoholic drinks and tobacco, customs duties, stamp taxes, and a variety of luxury taxes.

Russian communism really socialism

It should now be clear that what is commonly called Russian communism is not really communism but autocratic socialism, "state socialism." It has not brought about the socialization of *all* wealth or even of all *productive* wealth, for there is some private ownership of productive capital. A peasant may own a small piece of land, his dwelling, a cow and pigs and poultry. Individual handicraftsmen may produce goods in their own shops and sell them wherever they wish to; in 1935 some 15,000,000 men and women maintained themselves by private work of some kind—dressmakers, washerwomen, taxi drivers, journalists, artists, and scientists, among others. People who can save any of their income may deposit their savings in savings banks, or buy government bonds, and receive interest. What the government will not tolerate is the making of profits on the labor of others; no peasant, for instance, may hire a worker to help him, or rent his tract of land to anyone else. As the Webbs say: "The control of the instruments of production by individuals seeking to enrich themselves, and the power of the landlord and the capitalist over those whom they can employ at wages, or from whom they can exact rent, has passed away."[8]

Industrial leadership

One of the arguments against socialism and communism is that they cannot get the high grade of industrial leadership that is supposed to be winnowed out in the competition of a capitalist economy, and that the managers will not work so hard for the common good as they drive for private profits. The Russian experiment provides no definite proof or disproof of this argument. Conditions in Russia are so different from those in the technologically advanced capitalist countries that comparisons as to management are difficult to make. Some who have visited Russia, however, have been impressed by the apparent energy, intelligence, and efficiency of the factory managers; and the extraordinary production records of some industries indicate that management has been definitely good.

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[8] Sidney and Beatrice Webb, *Soviet Communism: A New Civilization?* p. 1123.

Labor. From the beginning of the Bolshevik regime, industrial managers faced a gargantuan task in training laborers for industrial work. Russia was almost entirely an agricultural country, with a very small percentage of industrial workers, and these generally illiterate and inefficient. Without doubt some of this inefficiency persists, yet progress has been extraordinary. Efficiency has increased; laborers are better fed, better clothed, better housed, and better educated; prior to World War II the working day had been reduced to seven hours; holidays are given with pay; and the workers enjoy more security than workers in most countries. There is practically no unemployment. Wages are lower than in the United States and in other advanced capitalist countries, but comparisons are difficult to make because the cost of living is not easily comparable and because the money wages do not represent all that Russian workers receive. Various types of insurance are carried for them, steady employment is practically assured, and they receive certain concessions in addition to their wages. Thus the workers in some plants pay only part of the rent on their homes, the balance being paid by the plant; some workers are provided with water and light either free or at reduced rates; and some plants provide cheap meals for their working force.

Labor unions. Laborers, even the intellectuals, are generally unionized, but the Soviet unions have a far different function than do the unions in capitalist countries. In the latter, labor organizes against the employer and fights for higher wages and better working conditions. Soviet labor unions are organized to give labor a share in the organization of the industry in which it is engaged, not to fight profit-making employers.[9] The unions are united in a central federation which is said to have some influence in the government. They discuss working conditions and plant management with some freedom, and the Webbs believe that there is actually more collective bargaining in Soviet Russia than in any other country. Apparently there are no strikes, nor does it seem likely that any would be tolerated.

Labor incentives. In its efforts to increase production the Soviet government compromises with the devil of human selfishness by allowing considerable differences in wages and encouraging speed and efficiency by offering various kinds of reward. Piecework payment, so hated by most union labor in capitalist countries, is general, and the workers are said to like it. Whereas workers in a capitalist economy regard it as a means of exploitation used by the employer to speed work to increase his profits, Russian workers see it as a means of increasing output and raising the standard of living for everyone. The Stakhanov Movement, another form of incentive, came into existence in 1935, when a young miner named Stakhanov devised a new method of mining coal which raised his output between 300 and 500 per cent and raised his wages proportionately. His method was not a new way to drive labor harder; it involved only more intensive labor specialization and greater efficiency in getting the coal out. Stakhanov became a national hero, and the Stakhanov Movement spread to other industries throughout Russia. It has been credited with some amazing increases in output—even, in some cases, to a level above that in capitalist countries.

Here is something new—laborers working happily under such driving incentives as piecework and a nation-wide efficiency movement, laborers, as the Webbs put it, with a "veritable passion for productivity!" How can this be? The explanation appears to lie in the fact that speeding up, greater efficiency, is not regarded solely as enriching a profit-minded employer, and that the workers have no fear of "working themselves out of a job" since there is no fear of unemployment. Unlike a capitalist employer, the socialist state is not compelled to seek a profit, and as long as the people want more goods, it can give labor the task of producing them.

Critics of socialism often argue that the socialist state might be very oppressive in its treatment of labor because it would be the only employer, and the workers would therefore have to put up with whatever conditions it chose to establish. If the Soviet government actually did produce all the goods, there would be logic in the argument; but, as we have seen, the central government does not produce all the goods. There is much variety, "multiformity," in government industries, and there are other producers—village, municipal, cooperative, and private. Nevertheless, there is some evidence that the freedom of workers has been more and more restricted in recent years. A decree of June, 1940, bound them to their jobs, forbade moving from one job to another without government consent; and this decree is said to have been not a war regulation but the result of a decade of development toward more autocratic control of labor.

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[9] *Ibid.*, p. 173.

Freedom in the Soviet Union

One of the strongest and most commonly heard arguments against socialism is that it would inevitably destroy the freedom not only of the workers, but of all the people. The socialist state, it is often argued, would inevitably take on an oppressive character, would be in a position to dictate to the people in every sphere of life—in their work, their leisure, their reading, and their religion. This was the general situation in Fascist Germany and Italy, and in some respects this is the situation in Russia; yet the Soviet government has tried, and with some success, to avoid it. In capitalist America, Norman Thomas, the Socialist candidate for the Presidency, is permitted to make speeches and write articles advocating a change from capitalism to socialism; and in some of the more liberal capitalist countries even communist candidates are allowed to speak and write freely, that is, within the limits set by their usually very limited campaign funds. Nothing like this would be tolerated in Soviet Russia. However, an amazing amount of free discussion is permitted along other lines; and the Webbs believe that there is not less freedom in Russia than in Great Britain or the United States but perhaps actually more. This, however, is highly doubtful. Certainly the freedom that we enjoy is of a very different kind from that enjoyed in Soviet Russia, and most Americans would undoubtedly think that they were in a tight place if they moved to Russia.

It is often assumed that the Soviet government is a personal dictatorship, but there may well be doubt as to this and as to whether the government itself represents complete dictatorship. Sidney and Beatrice Webb, whose *Soviet Communism: A New Civilization?* is perhaps the best available study of Russian communism, maintain that Stalin is not a personal dictator and that the government does not represent a dictatorship as did the Fascist governments of Italy and Germany.

Freedom in consumer choices. It is argued that the Soviet state has eliminated or sharply curtailed the freedom of consumers to determine what goods they will buy; but it is by no means certain that consumers there have less freedom of choice than consumers in the United States, except as far as there are greater poverty and fewer goods in Russia. Producers and advertisers largely determine many consumer choices in a capitalist economy, whereas in Russia it is the state that has this power. Consumers may do about as well there as in the United States.

Freedom of religion. The suppression of the church has often been cited as proving that Soviet Russia has destroyed freedom of religion; but in reality the only thing that has been destroyed is the *power* of a most oppressive church. There has always been a reasonable degree of religious freedom there, and it has increased in recent years.

Accomplishments of the Soviet regime

Feasibility of a socialist economy. The Soviet government has proved, at any rate, that it is possible to operate a socialist economy. Starting with an economy which was in complete chaos, the government has maintained its power, has fed and clothed most of the people, and has built up wealth at a rate which is probably not equaled in any capitalist country. This it has done, in spite of all predictions of failure, in spite of internal difficulties, in spite of the persistent hostility of capitalist governments, in spite of invasion by armies of several countries, in spite, finally, of the invasion, in 1941, by the powerful German Army. This record is impressive.

Development of new industrial capital. In spite of the vast cost of preparing for the war which was to come, the Soviet regime has developed a large amount of new industrial capital—hydroelectric plants; steel mills; automobile, tractor, and airplane plants; and factories for the production of many types of consumers' goods. It has extended and improved railroads, highways, and canals, has developed the nation's coal and oil industries far beyond any earlier production, and has made great advances in the training of engineers, chemists, and technicians. It has also done a great deal to pry agriculture out of its primitive, tradition-bound methods; to this end it has mechanized some of the collective farms and has encouraged the use of fertilizers, the scientific selection of seeds, and efficient methods of cultivation.

The Soviet Union's extraordinary growth in wealth is shown by the following figures from the League of Nations World Economic Survey for 1936–1937:

PRODUCTION OF NON-AGRICULTURAL RAW MATERIALS
(1925–1929 = 100)

	1925	1929	1932	1936
Soviet Union	61	137	194	388
Europe, excluding Russia	90	115	80	114
North America	91	111	59	102
Latin America	87	123	72	107
Africa	90	113	87	145
Asia, excluding Russia	86	118	108	173

Such figures seem hardly credible, yet some careful students of Soviet Russia insist that they have to be reasonably accurate because the Soviet government itself uses them as the basis of its economic planning. Assuming the correctness of these figures, we may well ask why Russia has built up production so much more rapidly than the capitalist nations. The answer is apparently that this increased output is due not so much to the increased productivity of individual plants as to the more efficient operation of the Soviet economic system as a whole, particularly the elimination of unemployment. In the chapters on the machine age we saw impressive figures on the increase in labor productivity in the United States, but we saw too that the labor and capital that remained idle during the Great Depression meant a loss of some 200 billion dollars in economic output. If we could have kept our productive resources fully employed and could have added the 200 billion dollars' worth of goods, our record would compare more favorably with that of Russia. Here, once more, we see the significance of the problem of unemployment. If we should some day find that the Soviet figures are heavily padded, there will of course be less to explain.

The construction of some of the Soviet's great public works has been accomplished at a tragic cost in human misery, not only in the denial of adequate food and clothing to the people as a whole, but in the slavery of many of the workers engaged on these projects. The Baltic–White Sea Canal and the Moscow-Volga Canal were built by political convicts, largely kulaks; 2200 miles of the Siberian Railway were double-tracked and other public works were built partly or entirely by the same kind of labor. Many of these men were arrested secretly and carried away without trial, and there is some reason to believe that the government trumped up charges against them solely to secure the necessary labor force. William Henry Chamberlin, a distinguished newspaper correspondent, estimated in 1934 that probably no less than two million people had been arrested without due process of law, many of whom were sentenced to concentration camps to work on various public works.[10] Living conditions for these laborers were desperately bad, and many did not live out their sentences.

The rapid increase in production in Soviet Russia has not solved the problem of poverty; that is too much to expect, in the brief period in which the new government has been in existence. The people are still poor by American standards, housing and clothing are inadequate, and there is barely enough food for all. But it should not be assumed that the complaints of scarcity, common even among the Russians, mean that the people suffer continual distress. As Strachey points out: "Paradoxically enough, . . . the creation of this feeling of scarcity (and it is undoubtedly a consequence of socialism) is one of the greatest achievements of the socialist economic system! *For it co-exists with an enormous increase over pre-socialist levels in the production of just those commodities which the popu-*

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[10] William Henry Chamberlin, *Russia's Iron Age*, 157. There is some evidence that although Chamberlin is a competent observer, he is somewhat prej against the Soviet regime.

lation feels to be scarce. . . . Socialism has greatly increased the supply of these goods. But at the same time, by distributing . . . adequate purchasing power to the entire population, it has increased the demand for these goods to a far greater extent. Hence the goods, in spite of a great increase in their production, have become scarce."[11] The socialists may have found the answer to the problem that perennially plagues capitalist nations—how to distribute enough purchasing power to enable the people who need goods to buy them, and so keep the productive machinery running at capacity.

Development of literacy. The Soviet government has developed literacy, in a country which was once largely illiterate, at a rate unprecedented in history. Soviet estimates indicate an increase in literacy from 33 per cent before the First World War to 90 per cent in 1932. Soviet educational methods are in some respects surprisingly modern, and progress has been extraordinary in technical and scientific studies. It is difficult, however, to appraise progress in what we call the cultural studies —literature, economics, and the arts, for instance. Chamberlin is very critical: "The harsh insistence, backed up not infrequently by administrative repression, that the 'Party line' must be the guiding rule in art and literature, as well as in politics and economics—all this tends to place on Soviet culture a stamp of dull uniformity, of unquestionable conformity to ideas and slogans which are handed down from above."[12] This might logically be expected where there is little freedom of the mind; yet there are some indications that a worth-while culture is developing, in music, drama, and also in literature.

A new status for women. One of the most important accomplishments of the Soviet regime is the emancipation of women, for the government has raised them to a new status of freedom and dignity, in line with Plato's view that women have much the same capacities as men and should therefore have the same opportunities, rights, and responsibilities. In Russia, woman's place is anywhere but in the home; on the contrary, her women are almost bound to work, for the parasitism of the obviously and avowedly idle women of America and the other capitalist countries is completely out of style. Factories provide nurseries to care for small children while the mothers are at work. Women are active in all kinds of trades and professions and take part in political activities; some hold important positions in the government.

Treatment of minority groups. The Soviet government has set a new standard for Russia, and indeed for the world, in its treatment of racial minorities. A little over half the population of the Soviet Union—that in the central and northern part of the country—are "Great Russians," a little over one-fifth are Ukrainians, and the remainder is composed of nearly two hundred other minority groups. The czarist government followed a generally harsh and repressive policy toward all smaller racial groups, particularly the Jews, who suffered frequent pogroms. The Soviet government has changed all this. Not only has it accorded equality and a large measure of self-rule to all groups, but it has maintained a definite policy of encouraging the preservation of the different racial cultures. This contrasts very favorably with Fascist policy, as we shall see later.

Progressivism. The Soviet government has broken down the mass of habit, tradition, and superstition that formerly encrusted the minds of the people. There was no hope in the czarist regime; it was dedicated to the task of keeping the people ignorant, superstitious, and subservient. The Soviet regime is trying in a thousand ways to lift them out of their old attitudes and into the habits and customs of the modern age; and there can be no doubt that it has achieved a large measure of success.

Foreign policy. It must be said, finally, that the Soviet Union has been about the only powerful democratic influence in international affairs. To cite only one illustration, in the Spanish Civil War the Soviet government was the only great power that supported the democratic government of Spain; and it was opposed by the governments of Nazi Germany, Fascist Italy, Great Britain, France, and the United States. To an increasing extent colonial peoples, and the masses of the people in many countries, are looking to the Soviet Union as their main hope for a more democratic world.

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[11] John Strachey, *How Socialism Works*, p. 80.

[12] William Henry Chamberlin, *Russia's Iron Age*, pp. 287–288.

Failures of the Soviet regime

Autocracy. The Soviet government, as we have seen, has remained an autocracy. The Marxian promises of a democracy have not yet been fully realized, nor does their realization seem likely in the near future. There is no general agreement among students of Russian communism as to the amount of freedom enjoyed.[13] The new constitution which was formulated in 1936 and was hailed as the most democratic constitution in the world granted "freedom of speech, freedom of the press, freedom of assembly," and many other rights; but there is some reason to believe that this was partly window dressing. The people are apparently permitted to discuss certain things with some degree of freedom, and within the Communist party itself there is considerable discussion of policies before they are officially adopted, but after they are adopted everyone must cooperate in putting them into effect. The elections are not as free as might be desired, for often, as in strongly Republican or Democratic sections of the United States, there is only one candidate for some offices. The situation has been summarized as follows by two American socialists, Norman Thomas and Joel Seidman: "There is no free speech, no free campaigning, no rival organization, no organized or unorganized opposition, no real election."[14]

The dissension among the party leaders and the liquidation of many of them does not indicate a very democratic situation. All the "Old Bolsheviks"—the group who initiated the Revolution—are now dead, some of them liquidated for reasons which are not quite clear; most of them were charged with disloyalty to the regime, and some actually confessed their guilt. A few writers believe that the trials were cooked up by Stalin and his associates to rid themselves of these men who, as national heroes, might become rivals; but other observers—notably Joseph Davies, at one time our Ambassador to Russia—are convinced that the men were actually guilty of disloyalty and that some of the army officers who were shot were really traitors. Perhaps the truth as to the Old Bolsheviks is that they were stubborn doctrinaires who could not adjust themselves to Stalin's regime and were removed to secure harmony within the party; but even so, such a program of wholesale liquidation does not suggest a regime of the highest idealism and brotherly love.

In the light of events since the German invasion of Russia, Stalin's policies on the whole seem very sagacious and his administration extremely efficient. It is now clear that, as Stalin himself believed, the rest of the world was in no mood to follow Soviet Russia to the communist Valhalla, that she would have to defend herself against military aggression, and that she would need powerful defensive armaments. Few observers believed that the Russian Army could withstand the German invasion for more than a few weeks or that the Soviet industrial equipment was adequate to support extensive military operations over any considerable time; some even doubted whether the Russian people would remain loyal to the government in a crisis, and suspected that the party itself and the army and navy were infected with inefficiency and disloyalty. On all counts, however, the Russian regime stood up beyond the expectations of any but a few sanguine observers; Soviet industry proved surprisingly efficient and the armed forces fought loyally and heroically under leaders who equaled the best that the war brought out.

Inefficiency of the economy. The centralization of authority characteristic of the Soviet regime doubtless contributes to efficiency in some respects, but in others it undoubtedly makes for inefficiency. The tremendous bureaucracy necessitates a heavy expense for its support, and it doubtless clogs up the economy to some extent with red tape and vexatious delays. The government is apparently quick to bring charges of sabotage whenever anything goes wrong, and this is a very serious offense in Russia, somewhat analogous to treason, and sometimes punished more severely than murder. Administrative officials live in such dread of this charge that they sometimes hesitate to make decisions and so develop a technique of "passing the buck" which slows down business seriously. Some evidence indicates, furthermore, that there is some graft and bribery in the bureaucracy, just as there was under the Czars and, perhaps we may add, as there is under capitalism.

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[13] For a favorable report on conditions as far as freedom is concerned, see Anna Louise Strong, *I Change Worlds.*

[14] Norman Thomas and Joel Seidman, *Russia, Democracy or Dictatorship*, p. 53.

Political offenses. In its punishment of political offenders—those who commit offenses against the state—the Soviet regime appears at its worst. Two American observers paint a dark picture:

> The penalty is death for stealing state property—in a country where virtually all production is carried on by the state. For saboteurs—and that term is interpreted very broadly indeed—the penalty may be death. "Wrecking" is one of the major crimes in the Soviet Union. Under Article 58 of the criminal code, one found guilty of "teasing, mocking, or persecuting" a speedy worker may be executed. The same penalty may be given farmers caught secretly grinding their private grain in a mill, since this implies an attempt to cheat the government out of a grain tax; a similar fate may await officers of a cooperative farm who encourage peasants to sow more intensively on their own private parcels of land. Death may likewise be the penalty for helping to organize a strike in the lumber industry, manned almost exclusively by exile labor. For attempting to cross the border illegally the penalty may be death. Under Soviet law of April 7, 1935, children over 12 merit the same penalties, except for the death sentence, as adults. The authors know of no other civilized country which thus treats child offenders.[15]

Still worse, the government sometimes punishes the families or friends of persons accused of crimes, even though they may be entirely innocent of complicity or any knowledge of the offense. This usually occurs when the accused person cannot himself be punished because he no longer is in the country. Thus anyone who flees from Russia without his family knows that his family will be harshly dealt with. In order to retain its hold on its representatives in foreign countries, the government at one time required their families to remain at home.

Snobbery. Not only is the government in some respects still a ruthless despotism, but there is clear evidence of the development of some class differentiation, with the party members as the new elite, and the rest of the population as the new proletariat, which is itself divided into various social classes. There is snobbery in Soviet Russia, as elsewhere. The workers for the new classless society apparently have no aversion to "class" if they themselves can have a place at the top. Just as we ousted the British aristocrats and built up an aristocracy of our own after our Revolutionary War, so the Russian revolutionists, to some extent at any rate, have liquidated the bourgeois and aristocrats, only to take their places as the real aristocrats. They do not show their superiority by wearing fine clothes, for that is "bourgeois," but they have other privileges. As Chamberlin says: "A high post in the Soviet Union carries with it a comfortable apartment, the use of an automobile, the right to eat in a good restaurant at a nominal charge, admission to the best rest homes and sanitaria in vacation time, a private car for travel on the railroads, and so forth."[16]

High birth rate. One reason why the Soviet government has not been able to raise the general standard of living faster is the country's high birth rate. When the government first came into power, it established what were probably the most liberal marriage and divorce laws to be found anywhere in the world and, utterly indifferent to the birth rate, legalized abortion—tragically enough, one of the most important means of keeping the birth rate down. More recently, however, it has adopted a stricter attitude toward divorce and has turned to encouragement of a high birth rate. Russia needs many things far more than she needs a rapid increase in her population. From 141.7 millions in 1917, the population rose to about 175 millions in 1941, which means that she has had to provide food, clothing, and shelter for more than 33 million additional persons—a fair-sized nation in itself. This would be a tremendous job even for a fully developed economy, and it has presented a serious problem for the limited productive resources of Russia.

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[15] *Ibid.*, pp. 32–33.

[16] William Henry Chamberlin, *Russia's Iron Age*, p. 269.

COMMUNISM IN THE UNITED STATES

Within recent years there has been widespread discussion of communism in the United States, and various individuals and groups have worked with might and main to protect the untutored masses from the insidious propaganda of the communists. In their pertinacious devotion to this self-chosen duty they have combed the membership rolls of liberal organizations and labor unions, lists of government employees, and directories of student bodies and college faculties. Some of these patriotic men and women have hinted or openly proclaimed that a vast army of communists in our midst is waiting only for a favorable time to take over the reins of government. They have compiled red lists and black lists of the leaders of this un-American cabal; among those they name are Senators, Representatives, professors, editors, preachers, charity workers, and labor leaders. They have defined the term communist very broadly to include socialists, liberals, New Dealers, and not a few of the irregular Republicans; and as a result they have made a very impressive showing. Congress provided generous funds for such committees as the Dies Investigating Committee to investigate all subversive movements, but particularly, as the Dies Committee interpreted the assignment, the communist movement. This Committee found the country infested with communists, many of them in high places; and its reports have so unnerved the great body of loyal Americans that many of them are afraid to sleep alone.

It is not known how many communists there are in the United States, but the number is certainly not very great. Of the less than 50,000,000 votes cast in the election of 1940, nearly 50,000—about 1 in 1000—were communist, not enough to frighten men of moderate nervous stability, unless it be assumed that these communists are persons of extraordinary ability, position, or wealth. Although there are considerable numbers of communists in a few of the more radical labor unions and a few unions are under communist domination, communists usually hold no positions of influence, and of course the power of intrenched wealth is always against them. The Communist party in this country is tightly organized along lines of almost military discipline, but it has shown its efficiency mainly in making trouble.

Hostility to communism waxes and wanes but it is probably less virulent today than it has been for some time. When Hitler invaded Russia, American public opinion turned rapidly to a more favorable attitude toward Soviet Russia, particularly when the Russians showed such surprising success in resisting the German Army. It finally dawned upon many Americans that the Russian communists were fighting our battle, and that our own freedom might well depend on Russia's continued resistance to Germany; and the "red baiters" who had hitherto found happiness and fulfillment in damning the communists became less articulate.

It is true that if the economic situation in the United States should become desperately bad—as bad as that of Russia when the Bolsheviks assumed control, or even as bad as that of Germany when Hitler seized the reins of government—there would doubtless be a growth of communist sentiment; but such a situation seems unlikely to develop soon. Even if it should develop, the American people might move toward democratic socialism rather than toward autocratic communism, and they certainly would be much more likely to succumb to Fascism than to communism. Under present conditions, there is absolutely no danger of a successful communist revolution; but as we shall see, there is grave danger that we shall fall to Fascism.

The widespread public apprehension with respect to communism is thus without justification, particularly when it brands our college students and faculties as largely communist, for these two groups, coming largely from the middle and upper-middle classes, are predominantly conservative in their economic and political philosophy.

Our treatment of communists

A question often raised in this country is: How shall we treat communists? Shall we allow them freedom of speech and assembly, as we do other dissenting groups, or shall we suppress them, clap them into jail whenever they express their views? Most of the enlightened countries of Europe have granted communists the rights accorded other parties, and some of our states have followed this policy, although many communist meetings, even when legal, have been broken up by Fascist hoodlums. But other states have passed laws outlawing communism and forbidding any expression of communist views.

The question of policy in this matter is not free of difficulty. Here are men and women who believe in violence, and openly or covertly advocate violence, who, according to well-known communist doctrines, would not hesitate to kill those who happen to stand in their way. Are they entitled to the civil rights which, if they were in power, they would not hesitate to deny to all who opposed their party's policies? Thoughtful students of government are in general agrement that while communists have no clear right to demand such rights, it is for various reasons unwise for the government to deny them. In the first place, the number of communists in the United States, or even ten times as many, would not constitute a danger which would call for their repression. Overt violence should not be tolerated, of course; but our present laws are entirely adequate to prevent or punish acts of violence, whether committed by communists or others. In the second place, it is usually unwise to suppress dissenting opinions, for it is through such opinions that many improvements in our political institutions have been achieved; we might conceivably learn from the communists, as we frequently have from other critics of the existing system. In the third place, suppression is not usually the best way to handle discontent. Communism springs from bad economic conditions somewhat as sunflowers grow in rotten straw stacks, and it is much better to correct the underlying evils than to suppress expressions of discontent. Not infrequently the only effect of harsh repression is to increase the discontent or drive it underground and into a more radical form; free expression, on the other hand, acts as a safety valve for political dissatisfaction. In the fourth place, and most important, it is unsafe to embark upon a policy of repressing communists because it is certain to be extended to such other dissenting groups as the socialists and the moderate liberals. Few people are able to distinguish different forms of radicalism, so they lump all but the conservatives together as communists or "reds." It is the extreme conservatives, the "red baiters," who are the real danger to American democracy, as we shall see in the following chapter.

Communism no answer to our problems

In conclusion, it is clear that the achievements of the Soviet government, great as they have been along some lines, do not suggest that the Russian model of communism is likely to be a satisfactory solution for the growing difficulties of American capitalism. Communism is too completely different from our traditions; we feel toward it like the boy who, when asked if he would like to go to Heaven, answered, "Not yit." Even if we concede that the Soviet regime has been extraordinarily successful in some respects, its achievements may be due largely to the fortuitous circumstance that Lenin and Stalin and the other leaders, whatever their faults, have been extraordinarily able. But what assurance have we that communism necessarily calls forth able leaders? In an autocracy, much depends on the men in control; just as able leaders can accomplish much good, so incompetent or unprincipled leaders can work vast harm, perhaps even turn the regime toward Fascism.

QUESTIONS

1. Define utopian communism and Marxian communism. What is the latter, actually? Why has utopian communism so often been mixed up with religion?
2. Why is the violent revolution necessary, according to Marx? Why have such revolutions always failed, except in Russia? Is it wise to talk of shooting when the enemy has most of the guns? Is it wise in any case? Criticize Marx's theory of the revolution.
3. Why did the Soviet government have to collectivize the farms?
4. Describe the organization of the Soviet government. What is the relation of the Communist party to the government? Is Stalin a personal dictator?

5. Why do the Soviet officials leave some production in private hands? Why do they put the distribution of goods in the hands of several agencies, instead of organizing it systematically under a single government head?
6. How are productive factors apportioned among the various industries and products in Russia?
7. Describe the Soviet monetary and tax systems.
8. Compare labor unions in Russia with those in capitalist countries. How does the Soviet government try to secure labor efficiency?
9. Compare Russia with capitalist countries with respect to the freedom of workers and of the people generally.
10. Enumerate and discuss some of the significant accomplishments of the Soviet regime. What are some of its failures?
11. If the figures of production given in this chapter are accurate and if Soviet Russia's industrial production has increased much more rapidly that that of capitalist countries, what do you think is the most important reason for this increase?
12. Do you worry about the possibility that a communist regime may assume control in this country? Why or why not? Why do some influential people shout "Communism!" so insistently?
13. Why should all American communists not be sent to Russia? Why do we allow Norman Thomas, a socialist, to run for President? Would we allow this if he stood any chance of winning? Why should we allow Republicans to vote after four straight defeats? Would it not contribute to political harmony if we had only one party as the Soviet Union does?

Chapter 43.

Fascism

> *"Would you tell me, please, which way I ought to walk from here?"*
> *"That depends a good deal on where you want to get to," said the Cat.*
> *"I don't much care where," said Alice.*
> *"Then it doesn't matter which way you walk," said the Cat.*
> *"—so long as I get* somewhere,*" Alice added as an explanation.*
> *"Oh, you're sure to do that," said the Cat, "if you only walk long enough!"*
> *Alice felt that this could not be denied, so she tried another question. "What sort of people live about here?"*
> *"In* that *direction," the Cat said, waving its right paw round, "lives a Hatter; and in* that *direction," waving the other paw, "lives a March Hare. Visit either you like: they're both mad."*
> *"But I don't want to go among mad people," Alice remarked.*
> *"Oh, you can't help that," said the Cat, "we're all mad here. I'm mad. You're mad."*
> *"How do you know I'm mad?" said Alice.*
> *"You must be," said the Cat, "or you wouldn't have come here."*
> —Alice's Adventures in Wonderland

In discussing Fascism we again face the difficulty of precise definition; in fact, Fascism is more difficult to define than either socialism or communism. Even if we restrict the term to its original meaning, as referring to Mussolini's regime in Italy, there are various interpretations; but something similar to Fascism has dominated Germany under the name National Socialism, and more or less similar despotic regimes have gained power in a number of other countries—among them, Spain, Portugal, Cuba, Turkey, Greece, China, Japan, and several of the South American republics. For the present, Neumann's definition of German Fascism will serve: "Fascism is the dictatorship of the Fascist [National Socialist] party, the bureaucracy, the army, and big business, the dictatorship over the whole of the people, for complete organization of the nation for imperialist war."[1] We shall return to this question of definition a little later, after we consider the history of the Fascist movement in Italy and Germany. From the history we can learn much as to the nature of the movement.

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[1] Franz L. Neumann, *Behemoth*, p. 360.

The story of Italian Fascism

As was true of Russian communism, the antecedents of Italian Fascism run back through more than a century of struggle for the consolidation of the nation, a struggle from which Cavour, Mazzini, and Garibaldi emerged as national heroes. Prior to 1870, the Catholic church held a considerable area in central Italy, including Rome, which was known as the Papal States and constituted an obstacle to the unification of Italy; but in 1870 the Italian government captured Rome and, by restricting the Pope to the Vatican, a small section in Rome which he ruled as a separate state, completed the establishment of the nation.

Although geographical unity was thus established, Italy was never sufficiently unified politically to make possible a real democracy. The constitution which was drawn up in 1848 was patterned somewhat after the English model, but the king retained considerable power, there were so many parties that no single one ever received a majority of the votes, and until as late as 1919 the right to vote was so restricted by literacy and property qualifications that only a small proportion of the people could vote. Furthermore, the Catholic church for many years forbade its members to vote or hold office. The nation was further divided into an industrial north and an agricultural south, a landowning class and an agricultural laboring class; some of the landowners were nobles with huge estates, while the agricultural laborers were desperately poor, and many of them were radical in their political views. One-sixth of one per cent of the population owned one-half of the land. Lacking important mineral resources, Italy was dependent on foreign supplies of raw materials and fuel for her industrial development, and her comparative poverty forced her to depend on richer countries for her capital. Her overpopulation kept wages low, and the laboring class suffered even greater distress when the United States passed a law restricting immigration, thus closing an important outlet for Italy's surplus labor. Thus, even before the First World War, Italy lacked both the national unity necessary for democracy, and the wealth needed to keep her people contented.

The First World War did not of course improve her condition, for some 460,000 of her soldiers were killed and a million more were wounded. Her victory over the Austro-Hungarian Army was won after the armistice had been concluded. For all this, Italy received in the peace treaty very little of the spoils of war, which were mostly divided between Great Britain and France.

After the war, Italy faced a desperate situation at home. She had many wounded soldiers on her pension list, the budget was unbalanced, and the national debt, already several times as high as it had been before the war, was mounting steadily. A severe depression soon set in, and the number of unemployed grew steadily. Other nations were raising their tariffs to the grave injury of the Italian economy, dependent as it was on foreign trade for food and for the industrial development the nation needed to support the growing population.

With her economic affairs in such a condition, there was even less political unity in Italy than there had been before the war. She had more parties than any nation needed—Socialist, Catholic, Syndicalist, Communist, and Nationalist, the latter including a considerable sprinkling of discharged army officers, who were soon to take their places in the new Fascist party. No party was strong enough to gain control and put through a program for maintaining the stability of the government. There was, furthermore, no really capable leader in the government, and the integrity of some of the men then in office was suspect. To make matters worse, the workers, some of them influenced by propaganda from Moscow, staged strikes, and in 1920 took over and tried to operate some 300 industrial plants in northern Italy.

The seizure of the factories by the striking laborers alarmed the rich industrialists, and the general public was inconvenienced and irritated by the strikes of street railway and railroad workers. The government turned to a more hostile attitude toward labor as the strikers continued to take over factories, and a number of laborers were killed in the resulting fracases; this naturally led to further strikes and disturbances. To add to the confusion, gangs of "patriotic" Nationalists, led by army officers, went about wrecking socialist newspaper plants and beating up socialists and laborers. Although the striking workers soon evacuated the factories they had seized, the disorder continued, with the government doing little to stop it.

Such confusion provided an environment well suited to the exercise of the talents of a shrewd and ambitious but utterly unprincipled adventurer, Benito Mussolini. Formerly a socialist, there is some reason to believe that at first he hoped to become dictator of a communist Italy. Believing that drastic changes were coming in government, and that they would come under radical leadership, he sided with the workers in their strikes and advocated such radical policies as the transfer of land to the peasants, the eight-hour day, participation of the workers in the management of industry, nationalization of munition works, confiscation of a large part of the great fortunes, a heavy inheritance tax, confiscation of 85 per cent of all war profits, and death for profiteers. His *Fascio di Combattimento* (perhaps best translated "fighting hoodlums"), which he had founded in 1919, lined up with labor at first. A year or two later, however, Mussolini came to see that he would never go far as the leader of laborers and socialists. Sensing the importance of having the support of the army and of the wealthy capitalists if he was to rise in the world, he reversed his tactics and turned to the right, to fight the "red menace" and help "preserve law and order," all the time sicking his hoodlums on the socialists, liberals, laborers, and cooperatives.

His new strategy worked well, and brought him support from the army, the capitalists, the big landowners, and the Nationalists; and in 1921 his Fascist party won thirty-four seats in parliament. His strategy now was to prevent any party from securing enough support in parliament to formulate a policy to restore peace and unity to the distracted country. To maintain and increase the confusion on which he hoped to ride to power, he shrewdly threw his support first to one party and then to another, lining up his forces in whatever way would cause maximum confusion and prevent any one party from gaining control. The Socialist and Communist parties blunderingly helped him in this. Never sensing the ominous threat of the Fascist movement to their lives and liberties, they refused to join forces against Mussolini. The communists particularly failed to see the issues clearly, and were even rather pleased at the chaotic situation, which they thought would undermine the government and make way for the coming "revolution." The confusion persisted as one cabinet after another was voted out.[2]

In the meantime, Italy's economic situation grew worse; unemployment was widespread, many workers, particularly farm laborers, suffered actual hunger, and increasing numbers of people turned to Fascism. The Fascist movement, now organized as a party, gained the support of the classes needed to secure domination of the country—the wealthy capitalists and large landowners, who saw in it protection of their property and position from Bolshevism and from labor interference, and the establishment of law and order; the army, which was dazzled by Mussolini's promise of military grandeur and empire expansion for Italy; the powers at the head of the Catholic church, always hostile to socialism, although not all Catholics followed the church in this policy; and people of various other classes, particularly the unemployed laborers and farm workers whose condition was so desperate that any change seemed attractive. Like a great many American politicians, Mussolini offered no definite program, but he harped insistently on patriotism, on the danger of Bolshevism, on the government's defeatist policy in foreign affairs, and on its inability to get things done, for which he was himself partly responsible. His thugs and hoodlums roamed the country, burning, beating, and killing, forcing mayors and other local officials to resign and replacing them by Fascists. Lacking the support of the army and not much concerned anyhow, the government did little to stop this lawlessness.

By October, 1922, Mussolini and his Fascists had gained control of the railroads, barracks, and arsenals, and were able to march on Rome and take over the government, Mussolini himself waiting in a safe place until the march proved successful, and then coming to Rome to assume command. He had not announced that he sought dictatorial power, and for a short time there was some pretense of following constitutional procedure, but when the socialist deputy Matteotti, who tried to line up parliament against the Fascists, was murdered by one of Mussolini's gangsters, it was clear that democratic government was at an end. Within a few years his followers imprisoned, tortured, and murdered opposition leaders by the thousands; yet Mussolini's regime maintained only a precarious hold at times. At the time of the invasion of Abyssinia in 1935, for instance, he might have been unseated had he not been supported in various ways by the Tory British government, for neither this nor the Spanish adventure was popular with the Italian people, who had to pay the bills out of a national income already insufficient for a decent living.

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[2] One of the best discussions of conditions during this period and of the way Mussolini worked to increase the confusion, is to be found in Stephen Raushenbush, *The March of Fascism.*

Mussolini thus captured supreme power over a nation which was in deep economic distress, a nation in which, for various reasons, the capitalist system had bogged down, a nation with prostrate industries, widespread unemployment, and, as a result, a bitter class war. After he consolidated his position as supreme ruler—the King was only a figurehead, a mere decorative detail—he worked out a policy designed to bring political, economic, and intellectual and spiritual unity to the nation. Political unity he tried to secure by proscribing all parties but the Fascist and establishing himself as the supreme dictator. Recognizing the unifying influence of the war spirit, and also in payment of his debt to the army officers who had helped him gain power, he embarked on grandiose military adventures, sending conquering expeditions into Abyssinia, Spain, Albania, and finally, in the Second World War, into France. Just how much these military feats contributed to political unity is impossible to say; but since they were usually successful, they probably tended to build up public support for the government, particularly since there was strong resentment in Italy against what the people considered their unfair treatment in the division of spoils after the First World War. Mussolini also tried to build up political unity by propaganda, parades, and other devices quite as effective as any Barnum ever used. He was a great showman.

A nation whose chief outdoor sport is fighting should not depend too much on foreign trade; hence the Siamese twin of Mussolini's grandiose military program was his scheme for national self-sufficiency. To achieve this he limited imports of foodstuffs, in what he called the "battle of bread," and strictly regulated imports and exports of many other commodities. His plan was to develop his African colonies to the point where they would furnish Italy with necessary food and raw materials.

The most serious obstacle to economic unity was the struggle of laborers against employers. This was the rock on which Italy's democratic ship of state had crashed, and Mussolini tried to solve the labor problem by the pretended creation of the "Corporative State." It is still uncertain what this means, or whether it was ever actually in operation; but at any rate he proposed to create "Corporations" of employers and employees in the various industries. Within these Corporations the employers were assumed to direct operations as under capitalism, but were subject to the control of the state. Strikes were prohibited, but the Labor Courts which were established to interpret the laws governing disputes gave some protection to labor, for their decisions were often in favor of the workers. Collective contracts might be entered into by employers and laborers, with stipulations as to wages, hours of work, apprenticeship, promotions, and dismissal; but, like everything else, these contracts were subject to government control. Since the lower strata of laborers were insured against unemployment, the government spend considerable sums on public works to provide employment. Some of the workers enjoyed sports, excursions, and various other kinds of recreation, partly at public expense. But wages remained very low.

Although for a while Mussolini followed a policy rather favorable to the wealthy capitalists who had helped him achieve power, his government gradually veered to the left, toward more intervention in business and heavier burdens on businessmen. Businessmen were now free from the danger of strikes, but they were themselves under the government's thumb; they had to make heavy donations to the Fascist party; they were obliged to secure government permits for imports and exports; they were expected to purchase government bonds with all their profits above 6 per cent; they could not raise prices without the government's permission, or establish any new business enterprise; and, unless they could bribe the collector, they paid extremely high taxes, and, on several occasions, capital levies. This mass of irritating and vexatious interferences should have been studied by the American capitalists who used to voice the slogan: "What we need is a Mussolini." The businessmen of Italy awakened too late.

The intellectual and spiritual unity of Italy, according to Fascist plans, was to be secured by propaganda and by government control over the press, the radio, and education. The Italian people read, heard, and were taught only what the government wished them to believe. Training in Fascist doctrine began when the child was six, and from then he was stuffed with patriotism, national pride, and military spirit, and trained to obey. Through athletics, hikes, and military drills the children were to develop strong bodies, but their fifteen years of Fascist "education" endowed them with little brains and no character, as character is understood among civilized people. Mussolini's vaunted intellectual and spiritual "unity" really amounted to the reduction of human beings to the level of army ants and termites, the denial of all intellectual freedom, originality, and individuality, and the abrogation of all cultural values.

History of Fascism in Germany

Antecedents. Like the Bolshevik Revolution in Russia and the Fascist movement in Italy, the Nazi, or National Socialist revolution—as the German form of Fascism is known—had its roots far back in German history and traditions. Soon after the Napoleonic Wars, Prussia began to build a strong military state, which within a few decades waged successful wars of conquest against Denmark, Austria, and France, gaining additional territory in each war. The German tradition of militarism and conquest thus goes back nearly a century. After the defeat of France in 1871, the German Empire was created, the King of Prussia becoming the Emperor; and Prussia's military tradition was extended to the Empire, along with the theory of the divine right of the Emperor—the *Mich und Gott* tradition.

In 1914 Germany and Austria-Hungary engaged in war against Great Britain, France, Russia, and much of the rest of the world. The Germans expected to win in a short time but instead were defeated after four years of bloodshed and suffering. At the end of the war the Kaiser fled to Holland, and the Germans, half-starved, with their industrial equipment in disrepair, with several million young men dead or wounded, and with heavy reparations to pay to the Allies, faced the problem of establishing a democratic government. The armistice in 1918, however, was followed immediately by uprisings, and the communists and radical socialists set up governments in several cities, patterned to some extent after the Bolshevik government in Russia. These uprisings were soon suppressed, in some cases with the help or connivance of the British and French governments; and the Weimar Constitution was adopted, a genuinely democratic instrument resembling rather closely the Constitution of the United States.

The new government faced a host of difficulties. Germany was economically impoverished, physically exhausted, spiritually disheartened, burdened with heavy indemnity payments; other countries were raising their tariffs against her goods, thus making it difficult to secure the exchange with which to make reparations payments; the rich industrial area of Alsace and Lorraine had been restored to France, and other parts of the former empire had been given to Denmark, Belgium, and Poland. Further difficulties appeared in 1923, when the French occupied the Ruhr as the penalty for Germany's failure to keep up her indemnity payments. This brought on a critical economic situation in Germany, one of the results of which was a disastrous inflation which wiped out the savings of millions of people and caused widespread suffering.

In the face of all these difficulties, the government did not manage affairs very effectively, partly because this was impossible under the prevailing conditions. The Weimar Constitution was a democratic instrument and the Social Democratic party, representing the laboring classes predominantly, pretended to govern, but powerful reactionary classes still held a great deal of power and worked persistently to weaken the government. The Junkers, the big landowning aristocrats closely associated with the military, were never reconciled to democracy; the monopolists, more powerful in Germany than in any other country except perhaps the United States, fought the labor unions and the government; the army officers dreamed of the grand old days of military glory and were scheming to restore a reactionary, militaristic regime before the ink was dry on the signatures to the Versailles Treaty; the bureaucrats and judiciary were generally reactionary, and hostile to democratic government. The attitude of the judiciary is indicated by the punishment ladled out for those who were in the communist uprising of 1919 and that imposed on the participants in the Hitler *Putsch* of 1923. For participation in the communist uprising, 2209 persons—everyone in any way connected with it—were sentenced to long prison terms; for the Hitler *Putsch* four men, including Hitler, were sentenced to five years in a comfortable prison, and five others were given a year and three months. The courts were very gentle with Fascists.[3]

Unfortunately the Social Democratic party, like most labor-controlled parties elsewhere, was weakened by an internal split into moderates, socialists, and communists, and thus could not present a united front to the more closely knit and unified forces of reaction. The party did not have a majority of the votes anyhow, and like the Fascist party in Italy it had to secure a coalition with other parties to get anything done; this called for compromises on important issues which pleased no one. The party was not strong enough to dislodge the former privileged classes—the army officers, the old bureaucrats, the reactionary judges, the wealthy industrialists, and the Junkers—and therefore surrendered to them one power after another. The decline of parliamentary procedure was well under way in Germany before Hitler rose to power in 1933.

The government really faced an impossible task. Any definitely socialistic policy would unquestionably have brought intervention from Great Britain and France, for their powerful business leaders and aristocrats would have permitted no radicalism in conquered Germany. The German economy was so broken that it could not provide employment for some millions of idle laborers, yet the government, although nominally socialist, could not go ahead with the socialization of important industries to provide jobs for all; so it was obliged to adopt such ineffective palliatives as public works, housing projects, social insurance, and relief. Unable or unwilling to strike out on any course bold enough effectively to restore economic activity and create employment, it was blamed by many people of all classes for its ineffectiveness; it also was held responsible, but unjustly, for its acceptance of the terms of the Versailles Treaty. In reality, the reparations Germany paid to France came from Americans who during the postwar period invested in Germany billions which were never repaid. Instead of paying the heavy costs of government largely by heavy taxation, the German government issued paper money and bonds. In 1923 the per capita tax burden was only one-fourth as heavy in Germany as in England.

It was out of such economic muck that Adolf Hitler rose to power. An Austrian by birth, a corporal in the First World War, and a near-socialist in the first years after the War, Hitler in 1920 became the leader of a small group of radicals who called themselves the German National Socialist Workers' party. This party adopted as its program a peculiar mixture of nationalism and socialism. As early as this, Hitler evinced his warlike aims, his theory of the superiority of the German race, and other characteristic Fascist views; but he also advocated many radical measures, such as the elimination of unearned incomes, the nationalization of trusts, the breaking-up of department stores, and land reforms, profit sharing, and old-age pensions. Like the platforms of political parties everywhere, his program was phrased rather vaguely to make it appeal to as many people as possible. In campaigning, the National Socialists confined themselves largely to denouncing the Versailles Treaty, the Jews, the government, and democracy in general; for by emphasizing such negative appeals they could avoid committing themselves too definitely on any positive program.

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[3] See Franz L. Neumann, *Behemoth*, pp. 20ff.

The movement grew slowly until 1923, when Hitler staged his beer hall *Putsch* in Munich. This attempted revolution was promptly suppressed, and Hitler was sentenced to prison for five years; but for some reason the government he had tried to destroy treated him with great leniency, imprisoning him in the comfortable Landsberg fortress were he was shown considerable courtesy and was able to write his National Socialist Bible, *Mein Kampf.* He was soon released, for the movement he headed seemed to have died out. However, the inflation of 1923 and the attendant speculation and profiteering, the unearned gains and unmerited losses, the shifting of wealth and income from the creditor to the debtor class, the shift of large numbers from the middle classes to the working classes, and the widespread economic chaos and stagnation that resulted from the inflation—all these brought forth new classes with grievances against the government; and Hitler and his National Socialists were able to poll 2,000,000 votes in 1924. Soon afterward, under the Dawes Plan and the Young Plan, Americans poured billions more into Germany and so helped to stabilize her monetary system and tide her government over the next few years, even to promote several years of booming prosperity, during which the National Socialists made little progress. In 1930, however, Germany, like the United States the year before, was struck by a severe industrial depression; and in the economic distress and revolutionary disorder that followed, Hitler rose to the chancellorship, which he expanded to complete dictatorship in 1933, just ten years after his inglorious beer hall *Putsch.* The man who for some years was regarded as a crackbrain had become dictator of one of the most powerful nations in Europe. How did he do this?

Reasons for Hitler's rise to power. One reason for Hitler's success lay in his political shrewdness, his knowledge of mass psychology, his oratorical skill, and his complete lack of all standards of honor and humanity. In the distress, hopelessness, and humiliation of the German people he found the conditions needed for success, for some of the people were ready to grasp at anything that promised relief from their troubles. Hitler had bait for almost every kind of fish. His emphasis on nationalism and war pleased the army officers, his promise of debt relief and land distribution appealed to the farmers, his promise of jobs caught some of the unemployed, his proposal to break up the department stores brought many small businessmen to his net, and his widely trumpeted hostility to communism finally brought financial support from the wealthy industrialists and bankers. The support given the Nazis did not run entirely along class lines, however. A great many young people of various classes, eager for adventure and seeing little hope for the future under the democratic regime, lined up with Hitler. Strangely enough, not a few preachers and priests—worshipers of the Christ Who preached love and peace and kindness and brotherhood—turned to worship the little corporal who preached hate and war and brutality and arrogant race distinction; Niemoeller, the well-known preacher who was later sent to a concentration camp by Hitler, was one of his early admirers. On the other hand, a great many of the working classes, particularly organized laborers, socialists, liberals, Jews, and the older people who remembered the sufferings of the First World War, were opposed to the Nazis.

As in Italy, the Fascist party in Germany achieved success because its opponents, the more liberal parties, were unable to present a united front. As in Italy, there were many political parties—some thirty-two at one time —and those who favored the retention of a democratic, parliamentary government failed to see the Nazi threat soon enough to unite against it. As in Italy too, the communists, with their peculiar genius for promoting confusion, sometimes voted with the Nazis against the government. Many of them were shot later when the Nazis gained control. In some respects the government under Bruening, just before the Nazis came to power, resembled our own under Franklin D. Roosevelt. It could not restore prosperity and employment, nor was it able or inclined to socialize production on a scale adequate to provide full employment. It dared not carry democracy so far as to divide up the Junkers' great feudal estates in Prussia or to democratize the industrial structure of Germany, where ownership of wealth was highly concentrated, with 80,000 people owning 35 billion marks, and the other 62,500,000 owning 16 billions, less than half as much. Nor did it feel strong enough to tax the rich heavily. On the other hand, it dared not skimp too much on unemployment relief and social services. So the government, neither aristocratic nor truly democratic, inept and vacillating, pleased no one fully. Moreover, the Germans had no long tradition of democracy but had always had a "Führer" of some kind to order them around, and some of them were already missing the pomp and parades of imperial Germany.[4]

Hitler in power. Once in power, Hitler proceeded to make his power absolute. He soon wiped out all the parties but the Nazis, sent many of their leaders to concentration camps, and gradually forced his political opponents from civil service and public life. The liquidation of the Jews was begun with sadistic cruelty. In the meantime, a split appeared within the Nazi party between the anti-capitalist wing led by Roehm, and the more conservative wing supported by Hitler and the army group. The anti-capitalist faction wanted to fulfill some of the campaign promises made to the lower classes, but Hitler's answer was the wholesale assassination of more than a thousand opposing "conspirators" in June, 1934.

The next year Hitler turned his energies to foreign affairs. In 1936 he reoccupied the Rhineland, which had been demilitarized under the Versailles Treaty; in February, 1938, he invaded and occupied Austria; the following September, under the infamous "Pact of Munich," he annexed the Sudetenland of Czechoslovakia, and a few months later took over the rest of Czechoslovakia, in flagrant violation of his solemn promise to respect her sovereignty. In March, 1939, on his threat to invade Lithuania, he secured the Memel district, including the little principality's only port. He did all this without military opposition from Great Britain and France, whose leaders failed to realize that their turn was to come soon.

In September, 1939, when Hitler declared his intention of invading Poland to regain the Polish Corridor, Great Britain and France finally declared war against Germany. Within a few weeks, however, the German armies overran Poland, and after a few months of an apparently "phony war" suddenly broke through Holland and Belgium, defeated France in a few weeks, chased the British armies across the Channel, conquered Denmark and Norway soon afterward, and assumed control of Rumania without serious opposition. How can this impressive record of victories be explained?

Reasons for Hitler's success. Since this is a book on economics and not military science, we need not discuss the military aspects of Nazi warfare further than to point out that the Nazis' "total war" was merely Germany's long-standing tradition of military efficiency carried to its highest stage of development. After Hitler came to power, all the productive powers of the nation, above those needed to produce a bare living for the people, were turned to the development of military power, particularly in war planes. This was done with great shrewdness and efficiency by a centralized authority, without the dillydallying of democratic procedure, and without the publicity necessary in democratic countries. Hitler knew what was going on in other countries and yet could to some extent keep his own plans secret. Another advantage was the fact that even before his time, Germany had been the most highly industrialized nation in Europe, with particular preeminence in the production of steel.

The Nazis did not win, however, by military strength alone, for Hitler played a shrewd game of undermining the strength of the nations who opposed him. Prior to his pact with Russia in 1939, he played heavily on his role as protector against communism; and this, together with his breaking up the labor unions in Germany, led many aristocrats, wealthy capitalists, and high government officials of other countries to look upon him as the defender of the privileged classes and to regard his successes with some complacency. Several French leaders—Laval, Flandin, and Bonnet, among them—and many of her "Two Hundred Families" (the wealthy families) were genuinely sympathetic with Nazi ideals and policies, for they feared their own radicals and laborers more than they did Hitler. Likewise in England, Prime Minister Chamberlain and other high officials, and Montagu Norman, governor of the Bank of England, followed foreign policies favorable to Hitler and Mussolini. Some of these even contributed to Hitler's campaign when he was rising to power. Some of the Polish Army officers did not defend their country against Germany at all, in the belief that Hitler would support them when he took over Poland and would help them keep the lower classes in control.

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[4] See Stephen Raushenbush, *The March of Fascism;* William Loucks and J. Weldon Hoot, *Comparative Economic Systems;* and Karl Loewenstein, *Hitler's Germany.*

The Fascist leanings of the British and French governments before September, 1939, are shown clearly in their policies during the Spanish Civil War. While Spain's democratic government was waging a desperate war against the Fascist revolutionist "Butcher" Franco—who was aided by Mussolini and Hitler—the British and French governments lined up with the three Fascist leaders and, by refusing to sell arms to the legitimate government, helped to bring about the overthrow of democracy in Spain. Our own government also helped in this, partly because we were following Britain's lead at the time, and partly because of the pressure exerted by the Catholic church, which, as owner of much of the wealth in Spain, feared that a democratic government might not respect its vast holdings.

The attitude of the privileged classes in England and France, it is now fairly clear, was based on their failure to understand either the Fascist movement or Mussolini and Hitler, until these men, particularly Hitler, had gained an almost impregnable position in Europe. Thus, as late as September, 1938, when the Pact of Munich was signed, Prime Minister Chamberlain apparently believed, innocently enough, that Hitler would refrain from further aggression in Czechoslovakia, in spite of the fact that the Nazi overlord had already repudiated many other promises. Like a great many others, Chamberlain could not yet get the conception of a man utterly without honor or integrity, could not see that he was dealing with a mere gangster.

Another reason for Hitler's victories lay in the fact that he was able to "divide and conquer" the countries that he wished to take over. Every one of those countries clung tenaciously to an isolationist policy, completely disregarding the fate of other nations in the blind hope that it would be left undisturbed, until some twenty countries had been overcome, one by one, in twenty months. Had the democratic nations of Europe combined in an anti-Nazi alliance, they might have stopped Hitler short.

Fascism defined

What is the real essence of the Fascist movement? This is a question about which even scholars differ considerably; and the vast majority of the people understand the nature of this barbarous system so little that, as Huey Long once said, if Fascism comes to power in the United States it may well come in the guise of an anti-Fascist movement. Since Fascism is the great overshadowing threat to democracy throughout most of the world, it is supremely important that we understand it as well as possible.

It is difficult to define Fascism precisely, for several reasons. In the first place, it takes different forms in different countries. There are Fascist forces in practically all capitalist countries, although in most cases they have not been strong enough to seize power. Confining our attention to the countries which are or have been dominated by Fascism, we find their governments supported, almost without exception, by the army and most big business. This was true in Italy, Germany, Spain, Argentina, Brazil, and Peru, among others. In Japan, big business has had great power in the government; but of course the wealthy industrialists did not help to put Hirohito or Tojo in power, as the German industrialists helped Hitler, and the dictatorship in Japan did not follow the overthrow of a democratic regime, as it did in most other Fascist countries. Japan was, and had been for years, a military dictatorship, a modern Roman Empire, although her government was concerned with the industrial development of conquered provinces more than Rome ever was. Fascism in Japan, if it can be called Fascism, differed in its origin and character from that found in most other countries. Turkey's government is a dictatorship, often called Fascist; but instead of being set up by powerful business leaders, it was the means by which an extremely able man, Mustapha Kemal Pasha, got rid of a decadent sultanate and made Turkey a strong, modern nation. Unlike most Fascist dictators, the Turkish leaders seem not to have any strong itch for territorial expansion.

As we have seen, in most countries the large landowners lined up with the army and big business in support of Fascism; this was true in Italy, Spain, Argentina, and Brazil, for instance. In Germany, on the other hand, although the Junkers were strongly reactionary and hostile to their country's democratic government, they did not support Hitler as long as he talked about breaking up the big estates. Yet it was Hindenburg, a Junker, who elevated Hitler to power, and at first the Junkers did fairly well under Hitler.

In various other respects Fascism differs from one country to another. The idea of race superiority, so characteristic of German and Japanese Fascism, was not so strong in Italy, and was not emphasized at all in Spain or the South American Fascist countries. Anti-Semitism likewise, carried to such lengths in Germany, was not very strong in Italy or in some other Fascist nations. The public support of Fascism also differs widely from country to country. A considerable number of Germans were fanatically loyal to Hitler, and most Japanese made a religion of their devotion to their emperor; but few Italians took their loyalty to Fascism as seriously as the more aggressive Germans; in Spain and some of the South American countries, so many of the common people are hostile to their Fascist rulers that they are held in subjugation only by the army. Fascist regimes also differ in their attitude toward religion. In Spain the Catholic church was one of the agents that brought Franco to power and has kept him there, the dictators of some of the Fascist countries of South America are likewise supported by the church, and Mussolini found it possible to live at peace with the church. Hitler, on the other hand, suppressed some of the churches, and Mustapha Kemal closed the monasteries and religious houses in Turkey, confiscated their wealth, and made the dervishes go to work.

Fascism is difficult to define, in the second place, because—at least in its earlier stages—it has meant different things to the different classes represented in the movement. To the Führer and the party leaders it meant power; to many party followers it meant government jobs and political spoils, and in some cases considerable wealth. To the rich businessmen and aristocrats it mean protection of their property from socialism and communism, and freedom from the exactions of labor unions; to the munitions makers it meant increased business and higher profits; and to the army officers it meant the glories of war. To farmers it meant protection of property rights, high tariffs and high prices, and relief from debt burdens and from what farmers regarded as the unfair demands of labor; to the unemployed it meant jobs—very poor jobs, as it proved—and security; to many bewildered and confused people it meant relief from the burden of trying to solve their economic and political problems; and to some bestial degenerates it meant an opportunity to beat and torture and kill, to indulge in an orgy of cruelty reminiscent of the Inquisition.

A third reason why Fascism is difficult to define precisely is that its policies have changed with time, and hence no definition will fit all its phases. In Germany, for instance, some big businessmen helped to finance Hitler in the belief that they could control him; but as he expanded his control over business, and particularly as he began to encounter defeat in his military adventures, the enthusiasm of the wealthy industrialists undoubtedly cooled, although it was too late to do much about it. Even more certainly, the small businessmen, who as a class supported Hitler at first, grew hostile when they found that Fascism was ruining them. In every Fascist country, government policies change from time to time, as all human institutions inevitably do. There is no "final" form of any human institution.

It is difficult to define Fascism, finally, because in no Fascist-dominated country has the

Fascist party ever had any consistent, unified program, plan, or blueprint, any definite, integrated, theoretical basis. Communism has such a program, based on the elaborate theoretical analysis of Karl Marx; communism is a definite thing—it is what Marx outlined in his books, mainly in *Capital*. The Nazis came to power with no blueprint in mind, no basic economic or political theory, except the craving for power; and they developed no such program or theory after they achieved power. Hitler's *Mein Kampf* was largely taken from Feder, Chamberlain, and others; and although shrewd in some of its insights—as when it asserts that the people are mostly boobies—and in its calculated appeal to the various classes of depressed and disheartened Germans, it was a far from logical and consistent exposition of Fascist doctrine. In fact, it was pretty largely a bundle of brutal, bombastic, utterly silly, and often inconsistent absurdities; anti-democratic, anti-liberal, anti-rational, anti-Christian, hostile to about everything that civilization has meant—in short, a program for a new "Dark Ages." The Nazis adopted an experimental technique in their policies; they followed the line of expediency, meeting every situation as it arose, without any theoretical preconceptions; and this of course meant changes in their policies from time to time. They were consistent and unchanging only with respect to their one end and purpose—power.

Various interpretations of Fascism

The ideological interpretation. Conceding the impossibility of exactness in defining Fascism, we may nevertheless consider some of the different interpretations of it. Some writers have interpreted it in ideological terms, as the fruit of philosophic teachings. In Germany, for instance, the writings of Hegel, Kant, Spengler, Spann, Treitschke, and, perhaps most important, Nietzsche, undoubtedly contributed heavily to that nation's glorification of war, of the powerful state, and of hard-and-fast class distinctions, with an elite ruling the less favored classes. Nietzsche thought that war should be the normal activity: "You shall love peace as a means to new wars—and the short peace more than the long. You I advise not to work, but to fight. You I advise not to peace, but to victory. Let your work be a fight, let your peace be a victory." He was equally clear regarding the theory of the rule of the elite, for he held that the world should be ruled by "a new vast aristocracy based upon the most severe self-discipline, in which the will of the philosophical men of power and artist-tyrants will be stamped upon thousands of years: a higher species of men who, thanks to their preponderance of will, knowledge, riches, and influence, will avail themselves of democratic Europe as the most suitable and supple instrument they can have for taking the fate of the earth into their hands and working as artists upon man himself."[5]

In 1899, Houston Stewart Chamberlain, an English admirer of German militarism, published *The Foundations of the Nineteenth Century*, which was one of the sources of Hitler's ideas. Mussolini, already in power in Italy eleven years before Hitler's rise in Germany, undoubtedly inspired Hitler to some extent and provided him with ideas as to strategy. Mussolini himself was doubtless influenced by the writings of Machiavelli, Sorel, and others, as well as by the famous economist Pareto.

Yet it would be easy to exaggerate the influence of such writers and philosophers. In the first place, these writers were themselves in some degree inspired by the prevailing ideas of their own time, rather than the cause of them; and in the second place, as Laski points out, Hitler and Mussolini were uneducated men, uninterested in philosophical systems; they formulated no clear and coherent programs, but were concerned solely with the strategy of acquiring power.

The communist interpretation. Marx himself did not foresee the emergence of Fascism. As we have seen, he believed that as more of the middle classes were forced into the proletarian "camp" and the number of proletarian workers increased, they would become more class-conscious and would finally rise and overthrow their capitalist oppressors and establish their own dictatorship. This was his general belief, although he saw vaguely the possibility that the ruling classes might be strong enough to prevent the proletariat from gaining control. Many students follow Marxian thought to some extent in interpreting Fascism. Their analysis runs somewhat as follows: In the later stages of capitalism, the business enterprises grow in size and decline in number until a few giant monopolies control industry; largely free from competition, these monopolies fix prices so high that the workers are unable to buy their products. Unable to market their full output at high prices, the monopolists restrict production and throw laborers out of jobs; the unemployed demand —and, as long as they can vote, they receive —relief payments and other social services; and taxes are increased to provide these services until the monopolists set up a Fascist regime and take the vote away from the people. Or the unemployed, and others who suffer from the economic paralysis, may lose confidence in the capitalist system and demand socialism or communism as a remedy for unemployment; whereupon the monopolist employers set up Fascism to prevent this and to nail down their power.

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[5] Quoted in Frank Munk, *The Economics of Force*, pp. 28, 86, 87.

To look at the situation another way, the monopolist capitalists find it difficult to maintain satisfactory profits. If they invest their profits at home, they encounter a declining rate of earnings, whereas labor unions maintain high wages. They can meet this situation in two ways, by investing abroad and by breaking up the labor unions and reducing wages; and both of these can be done better by a Fascist government than by a representative government. According to this view, the moving power which brought Fascism to power in Germany, Italy, and elsewhere is big business; and big business is assumed to have had a great if not dominating influence in the Fascist governments after they were established.[6]

The technological interpretation. There is a sense in which the technology of modern industry may be said to have created the conditions out of which Fascism emerged. In the first place, the tendency of modern industry has been toward larger plants, larger financial combinations, a more centralized business economy, all of which was easy for the Fascist dictator to take over. This development of large-scale business and centralization of economic power was accompanied by the progressive restriction of the fields within which individualism was the appropriate philosophy. In the second place, the great complexity in modern technology and industry created many new problems in government which the people of Italy and Germany were unable to solve democratically. In the third place, technological developments have in some measure been responsible for the failure of capitalism to function more successfully, particularly in relation to employment. Fascism could achieve power only in a time of deep economic distress. Finally, modern technology as employed in war—in machine guns, tanks, airplanes, and bombs—has given every army far greater power over civilians than it used to have, and so has facilitated the rise of the Fascist gangsters who secured control of the armies; and the radio has proved a vastly effective means for the psychological conquest of peoples.

The corporation interpretation of Fascism. The modern corporation has created the economic basis for Fascism by divorcing ownership from control in private business, and so setting the precedent for the Fascist method of control. As Munk points out: "Fascism has taken a lesson from the modern corporation. It has found out that it is unnecessary to take away the fiction of ownership if you can get hold of the actual control."[7]

This is true in another sense too, for in its internal management the corporation is a business dictatorship. The president is an autocrat, he hands down orders to the business "followers," and they are obeyed. Americans prate of democracy, but they can find little of it in the corporations which so largely dominate our economy.[8]

The gangster interpretation. The above interpretation is to some extent opposed by the gangster interpretation of Fascism. Fascism is a movement not of wealthy businessmen, but of outlaws, gangsters, who want power for its own sake, for the sake of national aggrandizement, and in some cases for their own pecuniary profit. Hitler and Mussolini began their careers as leaders of bands of thugs and outlaws, men totally devoid of any principles of right or wrong, of honor, honesty, or humanity. Not big business, but these gangster leaders, who are to be found in practically every country, are the moving spirits of Fascism, according to this theory, and big business is the victim of these gangsters quite as much as are other classes. Seeking absolute power, the leaders liquidate the leaders of all opposing parties, build up an army of secret spies to ferret out all opposition, harangue the people over the radio to secure mass support, imprison all who listen to forbidden broadcasts, and censor all newspapers, books, and plays—every avenue of access to the public mind.[9]

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[6] Excellent elaborations of this theory are to be found in Robert A. Brady, *The Spirit and Structure of German Fascism*, and Franz L. Neumann, *Behemoth.*

[7] Frank Munk, *The Economics of Force*, p. 57.

[8] See William H. Kiekhofer, *Economic Principles, Problems, and Policies*, pp. 81, 82.

Some students of Fascism rightly emphasize the significance of the middle classes, particularly the lower middle class, in the movement. For one thing, the gangster leaders come primarily from this class. Moreover, the lower middle class, even in normal times, does not occupy a very secure, dignified, and satisfactory position in the social economy, and in a deep depression its position becomes desperate. Unemployed laborers, small merchants on the verge of bankruptcy or already forced into the ranks of common labor, small farmers burdened with debt and striving desperately against the superior efficiency of large farms; teachers, professional men, and intellectuals who lack secure jobs or a decent income; war veterans unable to find a satisfactory position in civilian life—these provided the mass support for the Fascist movements in Italy and Germany. In the United States the Ku Klux Klan, in its revival after the First World War, was largely of this character. Strong mass support does not appear to be a universal requisite, however, for in Spain and in some of the South American Fascist regimes, as we have seen, the masses were hostile to the dictatorships which were imposed upon them by big business, large landowners, and the army.

Why do the people in the lower middle class turn to Fascism? Is it spontaneous, or is it the result of big-business propaganda disseminated through the press and radio? Frank Knight repudiates the notion that any social movement is the result of propaganda put out by leaders, business leaders in this case; and the history of our own Know-Nothing party, and of the Ku Klux Klan not many years ago, tends to support this view. But other students insist that big business, with its great measure of control over the press and radio, is largely responsible for the Fascist drift of middle-class opinion. Marx once said that the views of the masses of the people were the views of the ruling class, by which he meant that the masses derive many of their ideas from wealthy businessmen; and there is evidence that this is true in many cases.

Another question arises. Is Fascism controlled essentially by big business or by the gangsters; or, better, is it initiated and controlled by big-business gangsters or by small gangsters—paper hangers, for instance? This is perhaps the most important question, and the most difficult one to answer. In the case of Italian and German Fascism, however, a few conclusions seem warranted by the available evidence.

In the first place, big business and the Fascists saw eye to eye on some matters, and there was therefore no serious question as to which was dominant. Both wanted to break up the unions and keep labor impotent; both wanted to keep wages down; both were fanatically hostile to socialism and communism; both favored imperialist policies; both were anti-Semitic, certain business leaders because robbing the Jews meant loot and decreased competition, and the Nazis because robbing them brought in loot and because the constant tirades against them kept the people from thinking about other things; furthermore, anti-Semitism fitted their silly theory of the racial superiority of Aryans.

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[9] Among the best presentations of this interpretation of Fascism are Frank Munk, *The Economics of Force,* and *The Legacy of Nazism;* Hermann Rauschning, *The Revolution of Nihilism;* and Guenter Reimann, *The Vampire Economy.* In explaining the barbarous psychology of these gangsters, a number of writers emphasize the prevalence of various types of sexual degeneracy among them, but we shall leave this aspect of Fascism to the psychologists.

In the second place, practically everyone will concede that big business played a part in putting the Fascist gangsters into power. Big business helped to finance the campaign expenses of Mussolini and Hitler, not only Italian and German big business, but certain powerful business interests in Great Britain, France, the United States, and possibly other countries; for this anti-communist, anti-democracy dictatorship looked like the answer to Croesus' prayer. Hitler used this money to put himself into the driver's seat, and at first he tried to retain the support of these rich industrialists as far as possible because he knew their power and he wanted the support of powerful capitalists in other countries; he well knew that his bread was buttered on the moneyed side.

A third conclusion seems fairly well supported. While big business helped raise Mussolini and Hitler to power, doubtless in the belief that it could control them, there is no doubt that the Fascist party steadily increased its control over both big and little business. In Germany this was accelerated by the outbreak of the war in 1939, but since war is the purpose and end of Fascism, such a development seems inevitable. As long as the war proceeded successfully, as long as the armies were overrunning neighboring territory which they could loot, most of the German industrialists were probably fairly well content, for some of them shared in the loot and all looked forward to expanded markets and greater profits when all of Europe was conquered; but when the tide of battle turned and the armies of the Third Reich were in retreat before the Russian steam roller, these industrialists no doubt rued the money they had invested in Hitler. Even when Mussolini's wars were successful, they were probably less popular with the Italian business interests.

A fourth conclusion emerges from the study of Fascism in other countries than Italy and Germany. A gangster party is not essential to a Fascist regime; or perhaps we should say that the army may play the gangster role. This was true in Spain and in some of the South American countries; indeed the army—at least some form of an effective military force—is essential to Fascist control, just as the support of big business is usually essential at first. In Argentina the army, big landowners, and capitalists were supported by certain British capitalists who had investments in the country.

Analysis of Fascism

Fascism in Italy and Germany, although engineered largely by men from the middle class rather than by aristocrats, was politically an aristocratic regime. The elite—the gangster leaders—were to be dominant, subject only to whatever limitations the army and the rich industrialists might be able to set. Since neither Mussolini nor Hitler had any regard for the common people, the masses had no rights; they had only "duties," such duties as contributed to the power of the state—theirs only to "believe, obey, fight." As Hitler said in the first edition of *Mein Kampf*, "The German has not the faintest notion of the way the nation has to be swindled if one wants mass support." The end the Fascists sought was power, not a better living for the people; Fascist ideology was not primarily concerned with welfare, in spite of occasional references to the possibility of acquiring loot for the home folks through foreign conquests. One of the prime objectives of Fascism was to keep the people in subjection, an aim which was dressed up in wordy buncombe, particularly in what was called the "leadership principle." Hitler was not the "boss" or "dictator," he was the "leader," whose interests were of course identical with those of the followers; he was actually different from other mortals, a sort of God. There were sub-"leaders" in various fields; thus the factory manager was a "leader" whom the laborers were required to "follow" loyally.

The leadership principle was applied to conquered nations and peoples and races as well as to individuals. The superior German Aryans naturally were the leaders and the conquered peoples the followers, classified in a descending scale of inferiority, with Danes and Norwegians below the Germans but above the Poles and Russians, and Jews of course at the bottom. As Dr. Ley of the Nazi Labor Front expressed it: "The German race—that is our faith! It has higher rights than all others. . . . We have the divine right to rule, and we shall assure ourselves of that right."

Further to maintain public loyalty, the Fascist leaders ranted and harangued continually over the radio, built up real or imaginary enemies and dangers—the Jews and the communists, for instance—barred the expression of any news and views that might set people thinking, and, to the same end, kept the people marching and parading and shouting and cheering—anything that would keep them from thinking about the fact that their rights had been taken away. In leisure time as in working hours, the people must be dominated by the Fascist party, lest they fall into the habit of thinking.

If propaganda and marching failed to keep the people's minds in leash, there was always the Gestapo, the Terror, a veritable army of spies and snoopers which kept its Argus eye on everyone, seized everyone suspected of working against the regime, tortured confessions out of those suspected of belonging to underground movements, and killed those who were thought guilty. All this involved no legal procedure, for the decision of the Gestapo was final. Parents had to be careful in expressing opinions before their children, lest the children betray them; and no group of relatives or friends, could feel sure that there was not a spy in their midst who would report everything to the Gestapo.

The Fascists wanted power for its own sake and for the prosecution of war, for war was to be the permanent state of the Fascist nation —"a blessing of God, the eternal fount from which new generations of men are born." Every interest was to be subordinated to the achievement of power, not only temporarily, until the war was won, but permanently, since war was the chief glory of Fascist life. The subjugation of labor was of particular importance because it was demanded by big business, because the ranks of labor included most of the socialists and communists who opposed Fascism, and because, in order for Fascism to achieve maximum national power, the workers must be completely regimented and controlled. Since there could be no quarreling between employers and workers, the unions were broken up and their funds confiscated by the state. The laborers usually had to work where the Nazi functionaries and the employers assigned them, and for wages fixed mainly by these two groups, although there was some pretense that they had a measure of bargaining power; they could not leave their jobs without permission, they could not strike or demand higher wages, and they had to belong to the "Labor Front," a sort of bogus organization set up to preserve industrial "harmony" but, in Germany, for the most part under employer control. In short, labor was reduced practically to slavery; the Fascist autocrats of course never conceded this, but masked the idea of slavery in the characteristic verbiage about "leader" and "followers," the "labor community," and the "honor, faith, and care" that the laborers owed the leader and the fatherland. Slavery of course has one advantage—the slave always has a job. The Nazis provided jobs and, to keep the people as contented as possible, maintained a fairly elaborate program of social security, unemployment assistance, health and accident insurance, and sickness and old-age pensions.[10]

In Germany, the Nazis achieved practically complete control of banking, although, when they saw that they could control the banks without owning them, they returned to private owners large amounts of stocks in the big banks formerly owned by the government. The Reichsbank remained nominally in private hands, and for a time Dr. Hjalmar Schacht retained his position as its president, operating the bank somewhat along the same lines as before; but when the imperious demands of the war economy and the need for greater production of war materials, higher taxes, and increased state revenues created a situation in which banking carried on for private profit could no longer serve the needs of the state, Schacht was dismissed, and the government assumed control. Other big banks were similarly controlled, in many cases by making their officers high officials in the Nazi party or by putting Nazis in control of the banks. With the banks under state control, the government could get funds for its military exploits on its own terms; and its control of bank credit enabled it to direct industrial expansion into the channels necessary for the war which was being planned.

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[10] See Franz Neumann, *Behemoth*, pp. 431, 432.

The Nazis could secure control of business either by socializing it outright, as was done in Russia, or by regulating it. They chose the latter, partly because they realized that socialization would arouse the hostility of the property-owning classes, certain members of the government bureaucracy, the military classes, and, even more important, foreign governments. The Nazis shrewdly assumed the role of protector of Europe against communism in order to secure the support, or at any rate the benevolent neutrality, of the governments of capitalist countries, and any socialization program would have removed this support. Some socialization of business was carried out under Hitler—as for instance the Hermann Goering Works, which were owned by the party and not by Goering personally—but private enterprise increased more rapidly.

The Nazis took various means of regimenting industry adequately without socialization. Their control of banking enabled them to discourage businesses considered non-essential to the preparations for war by refusing them loans, and to encourage other enterprises needed in the war economy. Moreover, they directly controlled the establishment of new business enterprises and deliberately eliminated many others, particularly the small ones which they regarded as unessential or inefficient. Finally, through their control of raw materials, equipment, and labor, the Nazis were able to encourage or starve out any kind of business or any individual concern. Big business was generally favored, as opposed to small business, because it was assumed to be more efficient; but big business was itself rigidly regimented in the interests of the war economy. The huge steel, coal, oil, and magnesium companies made profits, in some cases high profits; but the government forced many of them to invest these profits in plant enlargement or in new industries of doubtful profitableness. The development of various ersatz (substitute) materials and the steady growth in the demands of war made necessary a great increase in productive plant.

In pursuit of power the Fascists regimented agriculture, just as they did every other kind of productive enterprise. Because national self-sufficiency was a Fascist goal, agriculture was a special pet of the Fascists, and race and the soil (*Blut und Boden*) were given a mystical significance by the Nazis. In 1933 Hitler made certain farms hereditary; they could not be sold or mortgaged, and had to pass undivided to the heir. A peasant who was deemed to be acting contrary to the interests of the state or who offended the local party boss might be deprived of his farm. The government decided how the land should be cultivated, what crops should be raised, how they should be marketed, and what prices should be paid. The Fascists achieved considerable success in increasing the production of farm crops, but at a heavy cost to consumers, for food prices were exorbitant; as far as the farmer himself was concerned, he was relegated almost to the status of a serf.

Trade was regimented as closely as agriculture; in fact, wholesale and retail trade lost most of their characteristics as private business. Prices and wages were rather rigidly fixed, and merchants were hard pressed to remain in business as costs rose; if they lost money it was their own misfortune, and if they made profits the government took most of them. One German industrialist

> complained publicly that his works were under the control of no less than one hundred government bureaus. Including the offices that had to do with his raw materials, imports, and marketing, the total rose to two hundred and forty. A new profession has sprung up—the contact man who has connections with the party and is thus able to procure for the enterprise small favors from local or central government bureaus—usually not without compensation. More often than not, the "leader of the enterprise" (as the businessman is called in Germany) is disgusted and alarmed by the rapid trend toward complete Communism from which he is separated only by a paper wall, but he has no choice. Like every other "race comrade" he has only to take orders. Whatever he may think, if he continues to think, he must keep to himself. He is in constant conflict between his nationalism and the realization that he is headed for destruction. . . . Every business is living constantly under a sentence

of death. If it makes profits, it has no right to use them; if it makes no profit, it is liable to be closed.[11]

With the dominating purpose of building up the power of the state, foreign trade was even more closely regimented than domestic trade; for if the country's internal economy was to be completely controlled, it was of course necessary that foreign trade be similarly controlled. In Germany it was practically treason to export goods without a government license and it was a criminal offense to import goods without government authorization. Foreign exchange was rigidly controlled; about thirty different kinds of special marks were at one time required in various fields of foreign and domestic trade, each kind used for some particular financial hocus-pocus. Since exports were needed to secure imports of war materials, the government adopted a policy of export subsidies which called for heavy taxes on non-export industries. When Germany bought goods from foreign countries, she might take much of the total exportable surplus of a given crop, as she did with some of the Balkan countries, and agree to pay for it in German goods; however, these goods often proved to be not the locomotives, tractors, and farm implements the exporting country wanted, but harmonicas, cameras, or odds and ends that Germany happened to want to get rid of. Germany secured control of important European markets by variations of this sort of skullduggery, backed by political pressure. No individual importer or exporter in any other country could deal on even terms with the Nazi trade monopoly; nor could small countries deal safely with the Nazi trade agents, for although those agents represented themselves as concerned only about trade agreements, in reality they were government spies operating through trade channels to undermine foreign governments. Even before war broke out, Germany had in this way reduced a number of small countries to economic vassalage, followed, in some cases, by political domination.

In yet another way the power politics of Fascism comes clearly into view. Although the Fascist leaders in both Germany and Italy complained that they were "have-not" nations which needed more room for their people, they persistently worked to increase the birth rate by granting marriage subsidies and by exempting large families from certain taxes; this attempt was carried to such lengths that illegitimacy was no longer frowned upon. Mussolini occasionally held celebrations in Rome for the most prolific mothers in Italy, brought them there at public expense and accorded them great honor and a general good time.

Fascism and Russian communism compared

Fascism has often been compared with Russian communism, or Bolshevism; indeed, a few students once believed that Fascism would turn toward communism and that communism would shift toward Fascism until finally the two would be much alike. They *are* alike in certain respects. Both are highly autocratic, and in both the autocrat is backed by a tightly organized party; both aim at world conquest, but the method of achieving this has differed. The Nazis depended on outright conquest by the army; the Bolsheviks, on intrigue and propaganda carried on by the Communist party within the foreign countries; this policy has now been formally abandoned by the Soviet government. And there is a measure of fanaticism in both systems, for both train their youth to accept party creeds and policies without question.

Yet there are fundamental differences between Fascism and Bolshevism. In the first place, the forces which bring them to power are different; Fascism is brought in by businessmen, communism by the power of labor. Many uninformed people claimed that the Roosevelt administration represented an approach to Fascism; but this is the exact reverse of the truth, for Roosevelt was anathematized by businessmen and by practically all the American Fascists and was supported generally by labor. In the second place, Fascism leaves property in private hands, with the government regulating its use, whereas communism socializes productive capital; and from this distinction flow very important consequences. Fascism, representing to some extent the interests of monopoly capitalists, must make an effort to maintain private profits and must therefore keep wages low and use the power of the state and of the army to expand markets. Communism, on the other hand, is under no compulsion to make profits from its state-conducted business, except to the extent that it needs them to expand its industrial plant; and the end it seeks is not the endless cycle of accumulating profits for the business leaders, or the endless expansion of the state's power and the nation's boundaries, but a better living for the masses of people. Fascism is therefore indefinitely expansive and inevitably warlike, whereas communism, following the generally pacific principles of socialism, has been the leader in most peace movements.

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[11] Frank Munk, *The Economics of Force*, pp. 109, 136. By permission of George W. Stewart, Publisher, Inc., publishers.

In the third place, while Fascism and communism are both autocratic as to government control, Fascism is aristocratic in spirit, whereas communism is democratic. Fascism represents a caste system, not only for the present but as a final ideal; communism looks forward, in theory at least, to a democratic, "classless" society in the future. In the fourth place, Fascism stresses non-material ideals—the glory of the state, war and conquest—whereas communism, again following Marx, emphasizes the importance of the material comforts of life. Finally, Fascism—at any rate in Germany, with its theory of race superiority—is harsh with racial minorities, in contrast to communism's generous treatment of such groups in Russia.

Fascism in the United States

Doubtless the vast majority of the American people, at least those who get their economic views from the comic strips, the radio, or the movies, have the complacent idea that the defeat of Hitler and Hirohito has removed all danger of Fascism; but such a cheerful notion is quite without justification. Fascism is a world-wide movement, with more or less powerful Fascist elements in almost every capitalist country; and practically all the careful students of the subject are agreed that there is grave danger that the United States may adopt some form of Fascist government eventually. Indeed some distinguished economists and political scientists consider this almost inevitable. Let us examine our situation, bearing in mind the fact that in most countries Fascism has been backed by big business, the army, large landowners, and in some cases, but not necessarily, a Fascist party.

The United States has all the essential ingredients for a Fascist regime. She has about the most powerful and most closely integrated industrialists to be found in any country, integrated with the big banks, the railroads, and the press and radio. Although it is to be hoped that our business leaders are less Fascistically-minded than the German industrialists, many of them hate real democracy, and accord our American brand of it a measure of "mouth honor" only because it is not very democratic. The question as to how many of these men would back a clearly Fascist regime can be answered best in terms of "opportunity cost." A few of our industrialists, and some other people too, prefer Fascism to any other regime. Some have maintained an essentially Fascist control over a number of steel, mining, and textile towns. Other industrial leaders prefer Fascism to the New Deal or to any genuine economic democracy—like that in the Scandinavian countries, for instance—and nearly all of them prefer it to socialism or communism. Just how far we should have to go in the democratization of our economy before this business oligarchy united in a Fascist movement is difficult to predict; but Charles E. Wilson, president of the General Electric Company and presumably no neurotic radical, recently expressed deep concern as to the attitude of some of his associates: "Many of us in the 1930's feared that a left wing reaction would draw labor so far away from the main body of American sentiments that the gap could not be closed without a disastrous struggle. I tell you frankly that I am deeply alarmed today over the possibility that a right wing reaction may draw some sections of capital so far away from our traditions as to imperil the entire structure of American life as we know it."[12]

As we have seen, strong military support is an essential element in Fascism, and we now have the greatest army and the greatest navy in our history, a large number of officers and privates, and some millions of veterans, added to the millions of veterans of the First World War. Most of these men would be hostile to Fascism under ordinary conditions; but it is conceivable that if serious civil disorder should break out, as for instance in a time of deep depression, they might support some form of Fascism as a means of preserving order. The training and traditions of military men are such that they cannot well serve as the most zealous defenders of genuine democracy, and several retired army officers have already aligned themselves with the Fascist movement in this country.

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[12] A profoundly significant analysis of the great power and tight organization of big business in the leading Fascist and capitalist nations is to be found in Robert A. Brady, *Business as a System of Power.*

The hooligan element, the Fascist "party," is represented in America by various Fascist groups, at one time some 800 of them—"Black Shirts," "White Shirts," "Gray Shirts," "Silver Shirts," and various other colors of shirts, copied from Italian and German models. Two books, *Under Cover* and *Sabotage*, give detailed information regarding the individuals and groups that have been plotting American Fascism, some of them in cooperation with the German and Italian governments. Some have gone so far as to train in military camps for *der Tag* when the United States can be taken over. These groups include men and women of all classes, from the lower middle class to the wealthy who hold high social position, some churchmen—Father Coughlin and the Reverend Gerald Winrod, for instance—retired military leaders, businessmen, and a few Senators and Congressmen. Certain leaders in the movement claimed to have between twenty and thirty members of Congress working for the cause, but this may have been an exaggeration. The intellectual leader of the movement was the brilliant and able Lawrence Dennis, author of books on economics and political science.

American Fascism, like Nazism in Germany in its early stages, upholds a rather motley assortment of inconsistent ideas. It is fundamentally anti-Christian in its emphasis on hate and brutality; yet many of the organizations which have Fascist characteristics pretend a strong "Christian" loyalty—the Christian Crusade, the Christian Mobilizers, the Christian Front, and the International Catholic Truth Society. Although several of the leaders are Catholic prelates, not a few of the members are violently anti-Catholic. Scheming to upset American political institutions, our Fascists nevertheless use the word "American" lavishly in the names of their organizations—the American Destiny Party, the America First Committee, the American Nationalist Party, the American Mothers, among others—and also in the names of the papers or leaflets they publish. They pose as super-patriots, some perhaps sincerely believing, as Hitler did, that they really are destined to save America from something evil, but others fully aware that they can work safely behind the smoke screen of patriotism. Sometimes, but not always, "patriotism is the last refuge of a scoundrel."

The American Fascist movement has other peculiar aspects. Although Fascists are generally militaristic in their philosophy, they joined with true pacifists in trying to prevent our entry into the war and in opposing preparation for it, and some of them even tried to sabotage our war effort after we declared war. There is something incongruous in this association of Fascists, who idealize war, with pacifists and socialists, who sincerely hate war and believe no good can come from it; but the truth is that many Fascists wanted Germany and Japan to win.

American Fascists are in general agreement on a few points, however, and follow a clear-cut Fascist policy. Almost all of them are hostile to Jews, the late President Roosevelt and the New Deal, labor, communism, socialism, liberalism, and democracy. Politically they are reactionary and, like Hitler and his Nazis, threaten violence to all their enemies when once they are in power.

In dealing with Fascist conspirators, our government until recently adopted the policy followed by the German government during the period before Hitler assumed power. Just as that government struck savagely at socialist and communist conspirators but let Hitler and his gang go almost scot-free, so our government, although fairly liberal, spent hundreds of thousands of dollars hounding generally innocuous communists from pillar to post and smearing all liberals through red-baiting committees and "Gestapos," but paid little or no attention to the far more dangerous Fascists. Although leading Fascists vociferated, even over the radio, about the "international bankers," the "communists" and "subversive activities" (not their own), and the "communist Jews," taking phrases verbatim from *Mein Kampf* and the speeches of Nazi leaders, our government apparently did not dare or did not care to interfere. It is true that it prosecuted one of the German-American "Bunds," but with about the same zeal and vigor as a boy shows in washing his ears. Since one weakness of most democracies is that they are not really very democratic, the best way to defend ourselves from Fascism might be to make our economic and political organization more truly democratic; Laski argues convincingly that there is no other way to fight Fascism.[13] The Department of Justice, however, finally "cracked down" on thirty alleged leaders of American Fascism, but the trial dragged on for months, the presiding judge died, and the case seems to have been forgotten. As was true of Germany when Hitler came to power in 1923, democracy moves fumblingly in dealing with a movement of this type.

Just as Hitler was not at first supported by the industrialists, up to the present time there fortunately has been no definite tie-up between the Fascists and big business. A few of our Fascist leaders are themselves wealthy or are supported by wealthy men and women, but many other leaders and the rank and file are of the lower middle class. Whether, if the movement gains more power, big business will come in, as it did in Germany, remains to be seen.

What of the people generally, the John Does and Richard Roes of the wide spaces of America, where do they stand on this question of Fascism? It is commonly assumed that Americans are democratic to the marrow of their bones, that they will not stand for any Fascist control of their government, and that their long experience in democratic government will enable them to preserve constitutional processes; but this optimistic view is not well founded. Our people are democratic in some respects, and they do have a sentimental regard for what Carver calls the "almighty ballot"; but they often seem unable to do much good with their vote. During much of our history, many of our cities and states, and at times even the federal government, have been controlled by corrupt gangs of politicians elected by the ballots of the people. A large proportion of the people in some states are disfranchised through the poll tax and other similar requirements for voting; some Congressmen and Senators have been elected by as few as 5 per cent of the people of voting age.

From time to time, strong political movements which definitely resembled Fascism in many respects have sprung up in this country. The American party, or Know-Nothing party, was strong enough to elect several members to Congress before the Civil War; like the later Ku Klux Klan, it combined the functions of political party and fraternal order with various secret rites, and it declared its hostility to foreigners, particularly Catholics, to marital infidelity, and to socialism. Here was the typical Fascist hostility to aliens and socialism, occasionally carried to the point of personal violence. The Ku Klux Klan of post-Civil War days followed a similar race-hostility program, with the Negroes displacing the Catholics as the enemy to be smitten; and in the reappearance of the Ku Klux Klan in the depression that followed the First World War, Negroes, Catholics, and Jews were denounced and in some cases beaten, tortured, or killed. The Klan at one time dominated politics in several states and many cities. If it had had strong support from businessmen or if the depression had persisted, the Klan might have risen to formidable national power; but it failed to obtain any considerable support from business, and the return of prosperity led to a decline in its power. Following de Tocqueville, the Beards explain the resurgence of the Klan in somewhat the same terms in which Harold Laski accounts for the mass following of Fascism: "In a democracy which professes equality, the individual without special titles, riches, distinctions, or gifts feels an oppressive sense of weakness alone in a vast mass of general averages; and thus bewildered he seeks strength and confidence in an affiliation with kindred spirits."[14] In other words, when the mediocrities of the lower middle class dressed themselves up in the mystic bedsheets of the Ku Klux Klan, they began to feel that they were somebodies, just as the German nobodies did when they marched in parades and shouted, "Heil Hitler!"

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[13] Harold Laski, *Where Do We Go from Here?*

[14] Charles and Mary Beard, *The Rise of American Civilization*, vol. ii, p. 782.

We might go further and point out that several cities and a few states have at times been under the heel of bosses who lacked only a few of the attributes of Fascist dictators. Louisiana was for some years ruled by Huey Long, an able, astute, but unscrupulous demagogue, an almost typical Fascist "leader" except for the fact that he was not supported generally by big business. Thus it cannot be said that the American people are masters of the use of the ballot. It cannot be said either that they are particularly law-abiding, for lawlessness and violence have often been noted as characteristic of our people, particularly on the frontier. Lynching and kidnaping are peculiarly American customs, and the number of murders in proportion to our population has long exceeded that of most other civilized countries, including pre-Nazi Germany.

In every war, public opinion turns reactionary, nationalistic, militaristic, and violent —in other words, in the general direction of Fascism. This was why many socialists argued against our entry into World War II; they insisted that our collaboration in a war to destroy Fascism abroad would almost certainly bring Fascism at home. Up to the present time this prediction has proved false; indeed our government maintained democratic liberties in the Second World War far better than in the First. Nevertheless, the outlook is not altogether reassuring. We have a huge army, navy, and air force, and air bases scattered over much of the world, and we may yet embark on a policy of imperialism and assume the "white man's burden" of keeping much of the world in "order"—our own conception of "order," which presumably is superior to most others. Furthermore, probably less than 5 per cent of the people in this country have more than the vaguest idea of what Fascism really is, and many might well vote for it as a way of "keeping labor in its place." Some observers believe that a fairly large proportion of the people would vote for a mild form of Fascism if it were presented without the label. Most laborers would oppose it; but as in Germany in the early 'thirties, the laborers are seriously divided and unable to put up a united front, whereas business interests are well organized and unified in spirit and purpose.

How far might the United States go on the road to Fascist totalitarianism? It is impossible to see very far into the future, but unless our economic condition becomes desperate, it seems likely that we would stop far short of the absolutism attained in Germany and Italy. With our abundant resources and high standards of living, we should be able to stand a fairly serious economic breakdown without intolerable suffering and without a complete break from our democratic past. We may find some ground for reassurance, too, in the fact that in both Italy and Germany, as also in Russia, the totalitarian regime was in some respects similar to earlier regimes to which the people were accustomed; none of these countries ever had a firmly established democratic tradition. If our particular brand of Fascism followed our national tradition in the same way, it would be much less despotic than the Fascism of either Germany or Italy. And, finally, we in the United States have an element of security against extreme Fascism in the fact that we have never had a strong military tradition, we have no powerful neighbors to fear, and we have no feeling of resentment because of a national defeat or humiliation to which a Fascist demagogue could appeal effectively. For all these various reasons we may hope that if we retreat from our democratic principles, we will not go as far back as Germany and Italy went. We may be headed merely for a reactionary capitalism in which free speech will be considerably abridged and labor unions will have to fight against formidable opposition. If powerful capitalist groups could capture both the Republican and Democratic parties and select conservative candidates for both parties, they would not need to take away the people's vote, as Mussolini and Hitler did. The American people are accustomed to this form of disfranchisement and might not mind it very much.

It is possible that Fascism, in the sense of the abolition of democratic constitutional processes, may come in during a deep depression, either by a sudden coup, a quick seizure of power, or through the gradual whittling away of democratic rights. Suppose that in the next depression some 15 or 20 million workers are for years unable to find employment and that they demand—and are able to enforce their demand—that Congress dispense generous relief payments and engage in extensive public works projects at high union-scale wages. With the public debt already so great as to threaten national insolvency and with government expenses running above receipts in spite of heavy taxes, it would not be easy to pay for relief and public works either by borrowing or by raising taxes; yet those in distress would have to be cared for. The business leaders would fight to keep relief payments down, would insist that taxes were already too high; the unemployed, on the other hand, would resent their hopeless situation and their employment at made-work and would demand something better. Neither class would be happy. A situation so unstable might usher in Fascism along either of two avenues.

The business classes, in the first place, might decide that the demands of the unemployed and of other distressed groups were threatening the foundations of the system of "free enterprise" and, with the cooperation of army leaders, they might take over the government, possibly with the acquiescence of the President, who might be permitted to remain in office if he were satisfactory to business interests. This would be particularly likely to happen if the demands of those in distress were clearly unreasonable, as they might well be, or too dramatic—if they staged "hunger marches" or camped on the Capitol grounds in Washington, as they did during President Hoover's last year in office, or were definitely lawless. Perhaps all this will seem fantastic, utterly impossible in the "Good Old U. S. A."; but the same thing seemed fantastic to most Germans—before it actually happened. According to General Smedley Butler, such a Fascist coup was discussed and planned by certain Wall Street interests in 1934, with the American Legion serving as a "front"; but it was abandoned when General Butler refused to act as "leader" and published his report of the plot. A congressional committee of inquiry conceded that there had been such a plot, although it "whitewashed" the affair liberally. Significantly, most of the large newspapers paid little attention to it; some of them tried to laugh it off. Fortunately it failed. So did Hitler—the first time.[15]

Fascism might come out of such a depression situation, in the second place, through a widespread lower-middle-class movement, similar to the Ku Klux Klan after the First World War, either with or without business support. When people are in distress, perplexed, frightened, and hopeless, they may turn to any kind of economic panacea as drowning men grab at straws; and a shrewd and effective rabble-rouser might seem to them the New Messiah, just as Hitler did to befuddled and hopeless Germans in 1932. The history of such popular movements in America and elsewhere suggests that the people might espouse Fascism, which is designed only to enslave them, as readily as socialism, which at least is designed to preserve their freedom, dignity, and well-being. If such a movement were clearly anti-labor and anti-democratic, business leaders might encourage and finance it, as some did in Germany. If the movement turned to the left, demanding concessions to labor and the lower classes, or even socialism, big business might conceivably call in the army and take over the government. If the people's demands, backed up by votes, were so extravagant as to threaten national bankruptcy, as the Townsend movement did a few years ago, the upper classes might well believe that a Fascist coup was the only means of saving the country. No ruling class ever abdicated its power without a struggle, and business leaders would sincerely believe that they were saving the country from disaster—most people believe that whatever is good for them is good for their country.

In a deep and persistent depression, such as that out of which Mussolini and Hitler rose to power, it is altogether possible that business leaders, powerfully organized as they are, would in one way or another seek to abridge democratic rights, and that they might succeed. They might engineer a drive against "communists," a category which can easily be stretched to include socialists and all shades of liberals. The fact that with a communist vote of only one-tenth of one per cent we have had in recent years a widespread "anti-red" movement indicates that lack of a sufficient supply of "reds" would not discourage real patriots seeking something from which to defend American institutions. This red-baiting would be accompanied by a campaign against labor leaders and labor unions, masked partly as a drive against communists, a campaign which is already being carried on. The powerful industrial and financial interests would not of course stand alone in such a movement, for as in Italy and Germany they would have the support of many small businessmen and farmers, who would probably not understand the real nature of the program but would warm up to an anti-labor movement aimed at preserving "private enterprise."

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[15] See George Seldes, *You Can't Do That*, chap. 15.

Certainly there is a possibility that we may shift to a Fascist regime, but we may well be cautious about setting the date. It is impossible to weigh the myriad of economic, political, and social forces operating at any given time, or to foresee others that may arise in the future and perhaps upset the most careful calculations. New conditions might develop in the rest of the world which would strongly affect our own situation favorably or unfavorably; someone might come to the front who would lead us quickly into Fascism or away from the danger of it. It is altogether possible that if Hitler had been gassed a little more heavily in the First World War or if he had been less effective as a rabble-rouser, or if Hindenburg, the doddering old Junker who put Hitler in power, had still been in possession of his mental faculties, or if President Bruening had been an abler leader, or if Great Britain had had an able and genuinely democratic leader instead of the aristocrat Chamberlain—if any of a score of such contingencies had prevailed, Hitler might never have captured power and there might have been no Fascist regime in Germany. So in the United States, our destiny may be determined by apparently inconsequential circumstances.

It must be conceded, finally, that in recent years the United States has followed a foreign policy favorable to Fascism in some respects. In the Spanish Civil War we lined up with Hitler and Mussolini in support of the Fascist Franco, to the extent of refusing to sell arms to the democratic government of Spain. After we entered the Second World War, we entered into an agreement with the French Fascist Darlan as a means of getting our army into Africa with the minimum loss of life; but after he was shot and we had adequate bases there, our government continued to play along with the Fascist leaders. When Italy surrendered, we left Badoglio, the same general who had served under Mussolini, in command of the Italian Army, and other Fascists were continued in many offices. In occupied Germany, according to many reports, our government has rather consistently refused to give the anti-Nazis any important part in the government and has even retained known Fascists in positions of some power. In Japan we have kept Hirohito in power, probably in fear that if he were unseated the country might turn socialist or communist; in China we have consistently backed the Fascist dictator Chiang Kai-shek. In many of its foreign policies our State Department has given ample evidence of a genuine liking for Fascism, or at any rate of a preference for it over any possible alternative form of government. The choice before many peoples—those of France, Italy, Spain, Austria, perhaps also Germany, China, and Japan—lies not between capitalism and Fascism but between socialism or communism on the one hand, and Fascism on the other; and in that situation our government usually supports Fascism.

QUESTIONS

1. Outline the various interpretations of Fascism. Are they altogether contradictory? Why is Fascism difficult to define?
2. What classes have been favorable to Fascism in most of the Fascist countries? Which classes are usually opposed?

3. Fascism usually comes in when a capitalist system cannot be made to work effectively, to provide employment. Illustrate from the history of Italy and Germany. In such a situation, why do not the people turn to socialism?
4. Why did Mussolini turn from socialism to Fascism? Why did Hitler drop most of his radical theories?
5. Since it came into power, the Soviet government has consistently striven to maintain peace in Europe; as long as they were in power, the Fascist leaders talked and threatened war. Why?
6. Why was the Weimar government in Germany, a labor and to some extent a socialist regime, so harsh in dealing with the communist uprising in 1919 and so lenient in dealing with the Hitler *Putsch*? Why did the British government, while fighting Hitler and Mussolini, release the British Fascist leader Mosley from prison after he had served only a year or two? Why did our own government, while fighting Hitler and Mussolini, generally prefer Fascist or semi-Fascist leaders as governors of liberated areas in Europe?
7. Could a Fascist coup be successful without army support? Could a Fascist movement achieve control through the vote of the people? How do you account for the fact that several men of generally Fascist views have been elected to Congress?
8. Why did the British and French governments cooperate with Hitler for several years?
9. Ask a dozen of your friends outside college to define Fascism. How many of them agree with the conception presented in this book?
10. Discuss the relation of big business to Fascism in Germany, Italy, Japan, Argentina, and Spain.
11. What was the real purpose behind Hitler's "leadership principle"?
12. Why did not the Nazis socialize German industry instead of merely regulating it?
13. In what respects is Fascism like communism and in what respects is it different?
14. Defend the statement that we have all the ingredients of Fascism in the United States today. Many able political scientists and economists believe that we shall have a Fascist government eventually. How do you account for this?
15. As the result of an extended survey, the National Opinion Research Center estimates that only 33 per cent of the people in the United States are able to name the United States Senators from their states. Does this indicate sufficient public interest to justify much hope that we shall be able to solve our many economic and political problems?

Part VIII

THE WAR AND POST-WAR ECONOMY

Chapter 44.

War and Peace

Causes of wars

In the chapter on imperialism we analyzed the various causes of war and came to the conclusion that economic causes, particularly imperialism, were usually very important. Doubtless there is some truth in the theory that man is to some extent a "fighting animal"; the thirst for glory has driven many leaders, and some of their followers, into warlike adventure; but economic motives have played a major part in most modern wars, although they are often camouflaged with idealistic phrases and slogans for the inspiration of the common people. Colonies, markets, raw materials, imperialist profits—these are what nations usually fight about.

It must not be assumed that the masses of the people usually wage war for the sake of selfish economic gain for *themselves.* It is generally waged by a small group of capitalist imperialists, powerful in business and influential in the government, who can see gain for themselves in a war and are able to enlist the people's support, sometimes amounting to fanaticism, by dressing up the adventure in the garb of a holy crusade of some kind. If a war had to be profitable to all or most of the people, there would be few wars; but certain small groups may benefit from them.

To some extent, this description fits the Second World War. To some extent, that war was a fight among rival imperialist powers; but it was much more than that. It was a death struggle between capitalism and communism on the one hand, and Fascism, on the other; it was to some extent a struggle between the ideals of freedom and democracy and the ideal of dictatorship, notwithstanding the fact that autocratic Russia fought with the democratic nations, for she still proclaims democracy as her ultimate aim. For Great Britain, France, and Russia it was a struggle for survival as independent nations, for the Nazis repeatedly proclaimed their intention to reduce other nations to a condition of servitude to the master race. Finally, it was a class struggle in every country, the struggle of some conservatives, aristocrats, capitalists, and small businessmen, led by democracy-hating hooligans, against laborers, radicals, and liberals. We have seen that Hitler had supporters in every country, some of them very influential men, and that he liquidated the labor leaders and leaders of radical and liberal political parties in his own country.

The Second World War thus had three facets. It was an imperialist war, a war of ideologies, and a world-wide class struggle; and here we have the explanation for some of the contradictions and inconsistencies in it. The United Nations were supposed to be fighting Fascism; yet Britain, France, and the United States followed policies favorable to Fascism in Spain. Winston Churchill, while Prime Minister of England, spoke very kindly of the Fascist dictator Franco, and worked to set up a postwar Fascist regime in Greece. We have already seen that the British capitalists who had investments in Argentina lined up with the Fascists in that country. Although China was one of the United Nations fighting for the Four Freedoms, the government of Chiang

Kai-shek is apparently a Fascist dictatorship in practically every respect, backed by the wealthier classes and devoted to the task of keeping the poorer Chinese down.

The rising cost of war

When, in July, 1942, the Secretary of the Treasury announced a war budget of 67 billion dollars for the following fiscal year Americans were reminded sharply of the terrific cost of modern war. The cost of war has risen steadily for many centuries. In ancient Rome, as among primitive peoples today, armament was so simple and inexpensive that the state could arm every man who did not have his own arms. This was true early in our own history, for almost every frontiersman owned a rifle and could start off to war on an hour's notice—as he did at Lexington. Yet cannons were used in important battles, and they were expensive, as was also the ammunition for cannons and even for rifles. Not infrequently soldiers lived off the countryside, but an organized commissariat was necessary to provide food for large armies.

With increasing mechanization of the army, costs advanced rapidly and the proportion of men that could be used directly at the front declined, as did also the proportion of men who carried rifles. As late as 1892, a British battalion of 1096 men had 894 privates, or rifle and bayonet men, whereas a few years ago privates constituted only 14 per cent of the battalion strength, and the proportion is even lower today. An increasing number of the land forces are manned with expensive equipment —Lewis guns, anti-aircraft guns, motorized guns, trucks, tanks, and airplanes. The same change has taken place in naval warfare, from the wooden sailing vessels of the Civil War period to modern battleships costing 60 million dollars or more, that shoot projectiles costing more than $1000 apiece.[1] Looking at this problem from a somewhat different point of view, someone has estimated that the cost of killing an enemy soldier was 75 cents in Caesar's time, $3000 in Napoleon's, $21,000 in the First World War, and $50,000 in World War II.

Obsolescence in armaments, as in all machinery, is far more rapid than it once was. The spear of the Roman soldier, the rifle of the American frontiersman, remained adequate for many years; but today guns and ships are out-of-date in twenty years or less, and airplanes five years old are ready for the scrap pile. After the First World War, the German military leaders proceeded with plans for the complete rebuilding of their land, naval, and air equipment along new lines, and Germany under Hitler created a military machine far more efficient than that of Great Britain and France. The nation which is to wage war successfully today must be constantly improving its military equipment, and this calls for steady improvements in all industrial and scientific processes, for military activities can no longer be separated from industrial activities. Modern war, total war, calls for the united support of the entire economy, from steel mills and automobile plants to country garages and dairymen's herds.

A final reason for the rising cost of war is that the vast productivity of modern industry enables nations to have better wars, just as it enables them to have better roads and automobiles, better food and clothing and houses. The surplus above living costs has been rising, and in wartime that surplus is dedicated largely to Mars. The First World War, the total world-wide bill for which was some 200 billion dollars, cost more in money, in materials used, and in the destruction of wealth, than all previous wars put together; and World War II cost vastly more than all other wars, including the First World War.

Other factors which are not new have always tended to make war an extravagantly expensive business. Threatened by war and aware of the grave consequences of defeat, no government higgles and bargains in its dealings; and it must pay extravagantly for labor and materials because of the haste with which everything must be done. The army and navy, furthermore, have never been greatly concerned about costs and sometimes pay even more than is necessary. Finally, there is likely to be more or less graft and incompetence in the adjustment to war and in the conduct of it, although there was probably less of these in World War II than in any other war in our history. One of the factors making for extravagance in both World Wars, although to a lesser extent in the Second, is the "cost-plus" system often used in paying for war supplies. The fact that under this system the government pays the cost of production plus a certain profit is a strong invitation to extravagance and outright fraud, since contractors can make more profit if their costs are high. In a few cases that have come to light, contractors deliberately wasted or destroyed millions of dollars' worth of material by plowing under brass castings and steel pipes, burning surplus lumber, and in many other ways. Some kept labor on their payrolls although it had no work to do, thus earning a profit on the wages the government paid. The Truman Committee disclosed many such cases of deliberate waste—in one case, the building of a single munitions plant, amounting to some $25,000,000.

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[1] Elbridge Colby, in *Encyclopaedia of the Social Sciences*, vol. ii, pp. 210–218.

In an effort to avoid the wastes in the cost-plus system, the government tried other systems of payment in World War II, particularly "cost plus a fixed sum," a "fixed price," or a "fixed fee." Such systems eliminated the incentive to waste and extravagance; but the prices paid were often generous, for various reasons. Most of the producing concerns were more or less monopolized, and since the war material had to be produced speedily, actual costs were high. When some producers found that mass production brought their costs so far below the contract price, their contracts were renegotiated, at great saving to the government.

Prices of war goods are often high for still another reason. If all producers had about the same average costs, the government could offer a price which would not be very far above these costs; but the costs of the various producers of a given commodity often differ considerably, and in order to secure maximum production the government must either pay all the producers a price high enough to cover the costs of the least efficient producer, or pay different prices to different producers on the basis of their costs. The latter would of course create dissatisfaction and would offer opportunities for fraud in determining each producer's price. To solve these various difficulties, the government, in contracting for fairly well-standardized products during the Second World War, frequently based its prices on "bulk-line cost—the unit cost of the highest-cost producer whose output was necessary to meet this production requirement."[2] Such prices allow the lowest-cost producers to make profits, in some cases handsome profits; but most of these were presumably recaptured by the government through the excess profits tax. For unstandardized products and products that had to be specially designed, such as bombers, warships, new types of guns, and the like, the government obviously could not use bulk-line cost, and hence resorted to various other systems—whatever system would secure the things needed as quickly as possible. It was inevitable that many costs would prove to be excessive.

Total war

The Germans waged what they called "total war," war fought with the maximum power, with the most efficient use and coordination of land, sea, and air forces, and close coordination of all of these with civilian workers, industrial, farm, and professional. Total war means war carried on against all the people of the enemy country, civilians as well as soldiers, by every form of attack which promises success; it means war carried on by every military, economic, sociological, and psychological means of buoying up morale at home, and weakening, confusing, and paralyzing the enemy. It means war carried on with no moral or humanitarian scruples in the treatment of the enemy or of neutrals; it means lying, treachery, espionage, the murder of innocent hostages, the starvation of conquered people—anything and everything that promises an advantage in achieving victory.

Not all of this is new, of course, or peculiar to the Nazis. In most wars the participating nations have tried to use their military and civilian man power as fully as possible, have coordinated their forces as well as they could, have struck at civilians on occasion—as witness Sherman's march through Georgia during the Civil War, and the British blockade which brought starvation to thousands of German civilians during and after the First World War—have employed propaganda, and have been guilty of lying, espionage, treachery, and cruelty. Great Britain and France, in spite of their treaty with Czechoslovakia guaranteeing her independence, abandoned her to Hitler at the Munich conference when it appeared that they might save their own hides by doing so; prior to Pearl Harbor, the government of the United States sold Japan the steel and oil with which she bombed the helpless Chinese to bits, and in 1940 the British government closed the Burma Road for a while to prevent the Chinese from getting arms and supplies for their war against Japanese aggression. The foreign policies of all nations have usually followed the law of the jungle whenever it seemed profitable, whenever it served the "national interest."

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[2] For an excellent discussion of this point, see Charles O. Hardy, *Wartime Control of Prices*.

Yet the methods of total war as carried on by Hitler and his Nazi gangsters and by Hirohito and his war lords did differ, at least in degree, from the methods of warfare used by civilized nations. The Nazis were more efficient, more unscrupulous, more ruthless. In some respects their military programs evidenced a retrogression to earlier times—the shooting of hostages, for instance, and their declared purpose of reducing other peoples to the status of subjects and slaves. One reason why the civilized nations were so slow to comprehend the threat of Fascism was that they could not believe that such a barbarous regime as Fascism turned out to be was possible in the modern world.

Problems of war production

Before the Japanese air force struck at Pearl Harbor, the United States was engaged largely in the production of "peace goods"; she enjoyed what most of the people regarded as a safely isolated position and was unprepared, both industrially and psychologically, for a major war effort. A few factories were busy with war orders from Great Britain and Russia and China, but their output represented only a small fraction of our total production. The summons to war that came that clear Sunday morning of December 7, 1941, meant that half the nation's industrial power had to be turned as rapidly as possible from peace goods to war goods—from automobiles, radios, furniture, and refrigerators to ships, tanks, airplanes, guns, and munitions. How could such a tremendous shift be made with maximum speed?

Clearly the price system which directs production and consumption in peacetime could not alone effect this transition, although capitalist nations rely on it to some extent. But if the government takes a rapidly increasing proportion of the people's income by taxation or borrowing and spends it for war goods, it can rely on the mechanics of the price system to bring capital and labor into war industries, simply by allowing higher profits and higher wages for war production than can be earned in the production of civilian goods. In a general way, this is the main process by which the government tries to get the necessary war matériel; but for a number of reasons the process is not as effective as could be wished. In the first place, the people are unwilling to pay high enough taxes or to lend enough by purchasing bonds to enable the government to buy what it needs. In the second place, the price system may not operate quickly enough to meet the urgency of the demand. The fact that the government offers high prices for airplanes does not mean that airplane manufacturers can produce the necessary output at once; in order to increase production very much they may first have to build new plants, and this will take time. The war industries in a pacific country like the United States are normally not very large, not adequate to the vast demands of modern war; consequently an immense amount of new plant had to be built in both the First and Second World Wars before production could be expanded to any great extent. The producers of war materials, furthermore, might be unwilling to expand their plants at all without government guaranties covering the cost of such expansion, for if the war was short, they might be left with expanded productive facilities that were no longer needed. To meet this difficulty the government sometimes guaranteed these costs in some way, or itself provided the money for additional plants. In the Second World War it financed some 15 billion dollars' worth of new plants.

The price system, in the third place, assumes competition, and most of the war industries are effectively monopolized. If airplane production were highly competitive, the manufacturers would jump at the chance to bid on government contracts; but our war effort was delayed for several months after Pearl Harbor while plane producers higgled over the cost of new plants. The aluminum monopoly was even more recalcitrant. For several months after it was clear that additional production would be needed, it refused to expand its plants, and the government finally had to agree to build a number of new plants. The aluminum monopoly did not want to have too much productive capacity after the war. When the Japanese Army overran Malaya the United States found herself deprived of natural rubber, but in trying to develop the manufacture of synthetic rubber she ran headlong into an international monopoly, and it took months to get production started. Similarly in the case of magnesium, and indeed a number of other metals essential to war, the government was gravely handicapped because it had to deal with monopolies, with international cartels in particular.

Another method used to compel the shift from civilian to war production involved the establishment of a purchasing agency through which the government bought the total output of certain raw materials and then rationed them among producers according to priority, giving producers of war goods all, or whatever they needed, of these raw materials. This method, which was widely used in the United States and other countries, forces an almost immediate discontinuance of civilian production of some things.

A rapid shift to a war economy always creates bottlenecks which slow down production; and when one has been opened up, another takes its place. In the first year or so of the war, the scarcity of machine tools presented a serious problem. Modern industry needs vast amounts of tools and machines, some of them extremely complex and highly specialized as to function; and in some cases complete retooling had to be completed before production of war goods could be begun. The machines used in automobile production, for instance, were not adapted to the production of airplanes and tanks; hence complete retooling was necessary before production of the latter could be undertaken. Somewhat later, raw materials constituted a bottleneck, with scarcity of scrap iron and steel a critical problem; and throughout the latter period of the war there was a scarcity of labor, particularly skilled workmen.

In spite of all difficulties, the government managed in various ways to secure extraordinary production of war supplies, extraordinary as to promptness and volume. When President Roosevelt in 1940 announced his determination to step up airplane production to 50,000 a year, many people thought such a figure fantastic; but four years later 100,000 were being turned out. German submarines took a terrific toll of ships early in the war, but within a year or two the submarine menace had been largely removed, and our shipyards were turning out new vessels by the thousand. With the output of tractors and other farm machinery restricted and with some farm labor drafted into the armed forces, farmers faced many difficulties; yet by March, 1943, farm production had risen 20 per cent above the 1939 figures, and it rose further in 1944, so that, in spite of shipments of 1.5 dollars' worth of foodstuffs from March, 1941, to June, 1943, the people of the United States were better fed than ever before. The increase in the output of various manufactured goods between 1939 and June, 1943, is shown in the following table:[3]

All manufactured goods	101 per cent
Durable manufactured goods	178
Non-durable manufactured goods	36
Iron and steel	76
Non-ferrous metals	69
Lumber	16
Cement	19
Cotton goods	45
Rayon goods	43
Woolen goods	48
Shoes	8
Dairy products	94
Meat packing	38
Cigarettes	42
Paper, pulp	34
Gasoline	−5

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[3] From Frederick C. Mills, *Prices in a War Economy*, pp. 32, 33.

Fuel oil	27	"	"
Lubricating oil	9	"	"
Coke	50	"	"

Production of some of the critical war materials likewise showed an astounding increase:

	1939	1943
Aluminum	300 million pounds	2 billion pounds
Magnesium	6 million pounds	520 million pounds
Aircraft	280 million dollars	30–40 billion dollars
Shipbuilding	342 thousand tons	16 million tons

Output of most of these materials increased even more after June, 1943. It was an astonishing performance, and showed what our productive plant can do when in full, steady, and vigorous operation, when unemployment is eliminated, and when the country's full labor power is working hard for a common end.

Labor in war

With the onset of war, the demand for labor, particularly skilled craftsmen, became imperious and insatiable. Posts or stations had to be built for the training of troops, new war plants had to be erected, and production in the plants already operating had to be stepped up to the maximum as rapidly as possible, all this in the face of the fact that the best of the nation's young men were being taken into the armed forces; 11,000,000 of them were enrolled in October, 1944. Total war as fought today demands that more than half of the total labor power be shifted from civilian to war work with the greatest possible speed. This may be accomplished in various ways. The government may conscript workmen just as it does soldiers, and send them to work where needed. There is as much justice in drafting labor for munitions plants as for the army. Germany employed this method, and England and the United States used it to some extent. In April, 1942, President Roosevelt created the War Manpower Commission to mobilize the nation's manpower, and a few months later he gave its chairman rather complete power over the country's labor supply, with authority to decide who should work, where, and at what job. The Selective Service System, which had the task of building up our armed forces, was also placed under the WMC, which was thus given general supervision of the job of securing an adequate fighting force and of directing labor into essential war work. Although the Commission's powers and functions were later changed in various ways, it never was given enough power to enable it to do a really effective job of allocating men to essential jobs. The people were apparently unwilling to have so much government regimentation.

The government may also try to attract labor to war work by offering high wages, relying on the operation of the price system. This it did to some extent, and it was successful, but the cost was high. In building posts and plants the government paid wages as high as $100 or even $200 a week for only moderately skilled labor. Some labor was paid the union scale of wages and some more than that, with time-and-a-half for overtime; and such wages, together with the high profits often made by the contractors, made costs two or three times as high as they would be in normal times. Naturally these high wages, particularly those for overtime, came in for considerable criticism on the part of the public; but when work must be done speedily, its cost will inevitably be high. Whether somewhat lower wages would have got the necessary labor on the job fast enough cannot be answered here. When there is an imperious demand for labor, for more labor than can possibly be found, the government is not in a position to do much bargaining.

Labor relations. Labor relations often present knotty problems in wartime. The urgent demand for war materials puts labor in a very strong bargaining position; yet in bargaining —by a threatened or actual strike, for instance —the workers may appear to be sabotaging the war effort while soldiers are dying at the front. However bad working conditions are, however badly the workers may be treated, the public views a wartime strike as closely akin to treason; and of course the government cannot tolerate much interference with war production. Accordingly, in March, 1941, President Roosevelt set up the Defense Mediation Board and assigned to it the task of keeping peace in industry. The Board was moderately successful until a strike was called by the United Mine Workers, under John L. Lewis. When, after the attack on Pearl Harbor and our declaration of war, it became clear that really effective arbitration machinery was vital, the President called a conference of representatives of labor and employers. At this conference the two groups agreed that there should be no strikes or lockouts during the war and that all labor disputes should be settled by a National War Labor Board, to be appointed by Roosevelt and to consist of four labor members, four employer members, and four members representing the public.

The National War Labor Board, backed by the promise of labor and employers to keep industrial peace, was able to function with reasonable success; but a few strikes occurred, including a serious one by coal miners; and in June, 1943, anti-labor forces in Congress passed the Smith-Connally Law over the President's veto. This law authorized the government to take over private plants in which there were strikes, the same working conditions to be maintained as prevailed under private operation. It also provided penalties for instigating or aiding any strike, and required 30 days' notice of any labor dispute, after which a secret ballot was to be taken to determine whether the majority of the workers favored a strike.

The Smith-Connally Law was approved by few authorities on labor and was thoroughly disliked by the laborers themselves. It was criticized as an ungraceful gesture toward labor, for it carried the false implication that labor was not loyal to the war effort. The loss of man days through strikes in war industries during the war amounted to only about 0.1 of 1 per cent of the total days worked—a rather extraordinary record—and many of the strikes that were called were "wildcat" strikes, that is, called against the orders of union officials. Employer "strikes"—refusals to begin work on war contracts until management's demands as to prices and profits were met—probably delayed war production more than workers' strikes; but the public heard little about them, whereas labor strikes are played up strongly by most newspapers.

All this is not to suggest that labor's record in the war was altogether without stain. Some workmen were unreasonable in their demands; some unions forced workers on government jobs to pay union dues, even for temporary work, and some were reported to have clung to the make-work policies of prewar days. With practically full employment, it was inevitable that there should be some unreliable workers in war industries as elsewhere. There was considerable complaint of absenteeism—of laborers just failing to show up for work—but this was not always due to general worthlessness and unreliability, many war workers were worn out from long hours on the job or from poor living conditions—many had to live in trailers.

The unions had a better defense for their practices than most people realized. Union laborers knew that many employers made high profits on war contracts, and they felt justified in demanding a share of those profits. Some of the union dues which war workers were forced to pay were entirely too high, and without doubt a small part of them went into the pockets of union racketeers rather than into the union treasuries; but even so, the general policy of trying to build up strong union treasuries in wartime had some justification. There may be lean years ahead for labor, and if the unions have strong cash balances they will have a better chance of survival.

Whatever the ethics of union policies, it is inexpedient for any government to attempt to break up labor unions, à la Hitler, in time of war. That way lies Fascism. A successful war effort demands the wholehearted cooperation of labor, and cooperation is difficult to secure with a club.

Wages and wage control. Closely allied with the problem of labor relations in wartime is the problem of wages and wage control. By an act passed in October, 1942, known as the Anti-Inflation Act, President Roosevelt created an Office of Economic Stabilization, whose director was given broad powers, including control over wage rates, in the fight against inflation. The National War Labor Board was, however, entrusted with the task of regulating wages; and in December, 1942, the Board "froze" most wages and salaries of $5000 and less at the levels of September, 1942, but accorded workers the right to ask for consideration of their wages if they were grossly unfair. There were many demands for higher wages, but only a few were granted, for the Board of course realized that increases granted to one group would bring a flood of demands from others.

There was much heated discussion of the wages paid to labor, businessmen and farmers rather generally insisting that the wages were fantastically high, while many workers and labor leaders argued that they were not high enough to compensate for the rise in the cost of living. According to Mills' report, labor did rather well, for between 1939 and June, 1943, average hourly earnings in manufacturing industries rose 52 per cent, as against a rise of only 26 per cent in the cost of living. Actually, according to Mills, workers as a whole did even better than this, for there was practically full employment and many received overtime pay. The "average weekly payrolls" in manufacturing industries rose 204 per cent. Employees of non-manufacturing industries did not fare so well, although wages in most of these industries rose at least as much as the cost of living.[4]

These figures, however, present too favorable a picture of the wage situation during the war. The official government estimates of the rise in the cost of living was certainly too low. Prices had risen more than 26 per cent by 1943, perhaps more nearly 40 per cent; and by the end of the war they were probably about 50 per cent above the prewar level. Furthermore, some of the workers—those who had to move to new locations, to crowded industrial centers or new war plants—not only had the expense and trouble of moving, but often paid high rents for poor quarters that were in some cases definitely injurious to health. Finally, most of the jobs were temporary, and the workers could not be sure that their former jobs would be open to them when the war was over.

Farmers in war

In a time of war prosperity, every class is prone to believe that it is not getting its full share of the inflation pie. Farmers were particularly critical of the high wages of labor, yet it appears that farmers themselves gained more than labor in the Second World War, as in most wars. Between 1939 and June, 1943, while average earnings per hour in manufacturing industries rose 52 per cent, and earnings in non-manufacturing industries rose less than that, farm prices rose 107 per cent, and "prices paid by farmers" for what they bought rose only 39 per cent. To quote Mills' report again: "No other major producing group had gained so much since 1939 in the average unit value of its products or services."

The farmers pointed out that these generous gross returns were not all velvet; that they had to pay high wages for help; that with farm implements and repair parts hard to get, they had many difficulties in their work; that they worked long hours; and that their womenfolk had to help a great deal with the work in the fields. All this was true. The long hours and the work done by farm women should be considered as overtime and as an addition to the labor force which should be paid additional income, for when an industrial worker's wife goes to work, she earns additional wages. On the other hand, in some respects the figures of farm prices undervalued the farmers' relative gains. Whereas a rise in the cost of living took away most of the industrial workers' wage increases, farmers got much of their living from their own land, and their cost of living did not rise in the same proportion as prices. Furthermore, farmers were free from many of the hardships imposed by rationing; many of them lived better than they have since the First World War.

Business profits in war

It is often said that employers, businessmen, get the lion's share from war prosperity; and certainly some of them do well, and a few do extremely well. Government figures indicated a rise of more than 100 per cent in the net profits of all corporations, after payment of taxes, between 1939 and 1943; profits reached the highest figure in our history. Such figures, however, are hard to appraise. There are, on the one hand, some reasons for believing that these figures may understate the profits actually made, for actual profits can be hidden in various ways. Some corporations make extensive plant improvements and count them merely as upkeep in tax returns; in some cases the government pays for plant additions which are later likely to be given to the corporations by the government, or perhaps sold to them for a song or two; many corporations spend large sums on advertising and building up good will which may yield profits in the future, but deduct the costs as business expense on their tax returns. The Securities and Exchange Commission reported in August, 1945, that American corporations had 47 billion dollars in working capital, 23 billion more than in 1939, presumably built up out of profits.

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[4] *Ibid.*

It may be some years before we shall know how well businessmen fared. Reconversion to peace production involves considerable expense; and in spite of heavy wartime advertising, some of them may have difficulty recapturing consumer markets for goods which were not produced during the war. Doubtless most of them will do very well in their negotiations for the additional plants which the government built for them during the war; yet some of the plants may prove to be of little value. Much of course depends on our tax policy, the maintenance or abandonment of price controls, and a hundred other factors that cannot be discussed here. But on the whole it seems likely that most adjustments will be at least satisfactory, and probably generous, as far as big business is concerned. For small business the situation is far different.

Small business suffered during the war. Some of it—retail stores, repair shops, and small service industries—did indeed make handsome profits, but others were forced to close up for the duration. Most of the war contracts went to a relatively few giant concerns, although an effort was made to turn some of our war production to small manufacturing concerns through subcontracting or otherwise. The big concerns got most of the business, not because the government wanted to favor them particularly, but because government agencies, anxious to get the work done with the greatest speed and the least trouble, naturally turned to the large companies that had the means and techniques for mass production. Many war goods, such as guns, tanks, airplanes, trucks, and ships, can be produced only by industries in which big concerns dominate—the heavy industries, as they are called. Altogether, it seems likely that the war hastened the decline of small business.

Financing war

The government needs at least half the productive power of the country to wage total war, which means that it must have about half the national income to pay the costs of war. As we have seen, there are three ways of getting this money: by taxation, by borrowing from the people, or by borrowing from the banks. There is also a fourth way: by issuing paper money.

Theoretically, all the costs of war should be paid from taxes, and, practically, taxes should be raised as fast and as high as public opinion permits. Extremely heavy taxes would force consumers to curtail their personal expenditures, but that is exactly what the government wants; it wants labor and capital to shift from the production of civilian goods to war materials. Assuming for the present that the total production of goods remains unchanged, it is clear that if the government takes from the people half of their income, they can buy half as much as before, and half of the productive factors formerly engaged in producing civilian goods will have to shift to war production. This will be accomplished without any increase in purchasing power, without any of the dislocations caused by changes in the price level, without piling up debts for future generations to worry about.

If war costs are met by borrowing from the people, the immediate effect on the economy is the same as that of taxation. Both taxes and loans represent subtractions from the incomes of the people, a decrease in the amount spent for civilian goods; both tend equally, in the immediate situation, to drive productive capital and labor from civilian industries to war production. The difference between the two is that money taken by taxation is not returned to the taxpayer, whereas the money that is borrowed will be paid back at some future date, and the lenders have government bonds to represent their loans. Borrowing from the people does not tend to raise prices, but it leaves debts which may be difficult to handle later, debts which, in the past, have usually been repaid in money of higher purchasing power. In wartime, particularly toward the end of a war, prices are high—which means that the value of money is low—and in the depression that has always followed great wars in the past, prices are low, that is, the value of money is high. In paying war costs by loans from the people, the government is in the position of borrowing money of low purchasing power and later paying back money of high purchasing power—a rather stupid policy which has nearly doubled the cost, to the government, of the great wars of the past, including the First World War.

The developments following World War II may be different. The government may be able to prevent a postwar slump in the price level, or, in view of our stupendous war debt, it may raise the price level and pay bondholders in money whose purchasing power is lower than that of the borrowed money. During and after the First World War, the French government raised the price level about 500 per cent, which amounted to the repudiation of about five-sixths of the debt. To the extent of the repudiation, such a policy amounts to taxation, but it creates grave incidental dislocations and injustice which would have been avoided by taxation, for it involves the partial repudiation not only of government debts, but of all other debts as well.

The third method of paying for war, borrowing from the banks, is definitely inflationary. When the government borrows from the people, they have to reduce their expenditures for civilian goods to the extent that they lend to the government; hence such borrowing has no tendency to raise the price level because it does not increase the amount of purchasing power. Borrowing from the banks, however, has far different consequences, because the banks do not need to save the amount they lend to the government; they simply create it in the form of deposits. To the extent that the government borrows from the banks, consumers retain their former purchasing power and the banks create new purchasing power for the government; the government then bids against civilian consumers, forcing prices up. With higher prices, the government needs more money to buy war goods with, borrows more from the banks, bids prices still higher, and the rising spiral of inflation—increasing bank loans and higher prices—is on its climb upward.

This policy of financing the cost of war is entirely unjustified, if not stupid. Borrowing from banks involves trading government credit (in the form of bonds) for bank credit (in the form of deposits), a transaction in which the government pays interest to the banks, although its credit is of course better than that of the banks. Why should not the government borrow from its own banks, without any interest cost? There is no reason except that private banks would object. Why should not the government issue paper money for the purchase of war materials? There is no reason, in theory, why it should not do so, no reason why paper money should be any more inflationary than bank money. In practice, however, this might be a more dangerous policy, because it seems so easy. In the case of bank loans, the banks may exert a restraining influence on the expansion of loans, at any rate when their total mounts high enough to threaten their final repudiation. People might be more frightened if paper money were issued, because they know that governments usually resort to this only when they are desperate financially and can no longer borrow from the banks. But perhaps the people ought to be scared a little, for they might then be more willing to pay the taxes that war makes necessary.

Most people are averse to paying the taxes needed to meet the costs of war. A great many people apparently believe that if they do not have to pay too heavy taxes they can make a lot of money out of inflation and that by borrowing the money we can pass at least part of the cost on to future generations. We saw, in the chapter on public finance, that this reasoning is false, that there is no way by which the financial burden of a war can be shifted on to future generations. Furthermore, the sacrifice of the people of this generation is in general approximately the same whether the war is paid for by taxes or by borrowing—the sacrifice in the sense of abstinence from consumption, going without things. However the government gets the money to pay for war goods, consumers can have only as much goods as can be produced by the capital and labor that the government leaves for civilian production. If the government takes half the nation's productive resources, civilian consumers can have only what the other half can produce; whatever plan is used to defray the expenses of war.

The direct sacrifice of the people of future generations too, sacrifice in the sense of going without, will be the same whether we pay for the war by taxes or by borrowing from the people or from the banks. If we pay for it "cash down"—by heavy taxation—there will be no postwar hangover of indebtedness, no debts and no bonds; if we pay for it by borrowing, there will be debts and bonds which will offset each other. The next generation will owe *itself* the amount represented by the bonds; it will be in substantially the same position as if there were no debts and no bonds. (In any case, the next generation, like the present one, will of course be poorer by the amount of physical destruction and depreciation incident to the war.)

Does it, then, make no difference how we pay for war? The answer is that although it makes no difference in the *direct* burden on the people as a whole, it may make a great difference in the apportionment of that burden, and in the amount of the *indirect* burden imposed. As to the apportionment of the burden, in the first place, the general rule is that the more taxes are used, the greater will be the share of the war costs borne by the rich and well-to-do. If the costs of war were to be met almost entirely by taxation, all the people, including the rich, would have to give up all income above that needed for a modest living; and they would have no bonds stored away in vaults to reimburse them later. The rich and well-to-do would not necessarily lose any of their accumulated wealth—except as all lose through the waste and destruction of war—but they could not increase their wealth during the war. In the Second World War the very rich did pay extremely high taxes unless they were in some way able to evade them, but the well-to-do and moderately rich were not taxed so heavily.

If the war is paid for by borrowing, however, the rich do not fare so badly, for they can lend their surplus income to the government instead of giving it, and can increase their accumulation of wealth while the war is being fought. How much they gain depends to some extent on the tax system employed during and after the war. If the government pays its bond interest and gradually retires the bonds by levying heavy and steeply graduated income taxes, the rich will be somewhat in the position of paying interest to themselves and redeeming their own bonds; but if the government later raises a considerable part of its revenues through such regressive taxes as customs duties, excises, and sales taxes, the bonds owned by the rich—and most of them are likely to be held by the rich—will be paid partly by the poor.

In the second place, the method of paying for the war makes a great difference in the indirect burdens of war finance. If the costs are met by taxes, the people will suffer only the hardship of going without things; there will be no hangover of debt to worry about afterward, and no inflation. If they are met by borrowing from the people, there will be debts which later will inevitably present difficulties in fiscal administration, but no inflation. If the war costs are met by borrowing from the banks, there will be both debts and inflation, and the injustices and hardships that result from inflation must be added to the necessary hardship of going without things. Here we must include all the dislocations of price relationships that result from inflation—the unfair burden on creditors and salaried classes and on holders of life insurance; the hectic speculation that accompanies inflation; the disintegration of business morals; and, perhaps worst of all, the almost inevitable deflation and depression that follow inflation. If we had taxed more heavily in the war, we could have avoided these indirect burdens and our economy would be in far sounder condition.

These simple principles must, however, be qualified. We assumed that production did not increase, whereas in war the economy speeds up and production increases. In World War II, as we have seen, this increase was amazing—75 per cent, according to one estimate. Therefore the government could take half of the economic output for war, and yet the people had considerably more than half of their former output for civilian consumption. They had half of a greatly enlarged output of goods. Except for automobile transportation, fuel for heating homes, and a few other items, civilians lived about as well after Pearl Harbor as before, on less than half of the total economic output of goods, and some lived better than ever before. Since output increased greatly, the supply of purchasing power had to be greater too, for otherwise prices would have declined. To keep prices at their prewar level would have required a considerable increase in bank loans or in some other form of money.

Our fiscal policy in World War II fell far short of consonance with the principles analyzed above. The record is disheartening evidence of the people's incapacity to understand even simple economic problems. In every major war in our history we have been unwilling to tax heavily enough, have tried to evade the real cost of war, have tried to shift it to future generations, and as a result have practically doubled the costs. Although this record is clear, for all to read and consider, we have apparently not learned much from it. In fiscal year 1942, the government spent about 32 billions, approximately 13 billions of which was raised by taxation; in fiscal year 1945, expenditures were about 90 billions, of which 46 billions was raised by taxation. For fiscal year 1946, expenditures are estimated at 66 billions and tax receipts at 36 billions, if taxes are not reduced. The federal debt, which now stands at 258 billions, is expected to climb to 272 billions in July, 1946; and only an incorrigible optimist will believe that it can long be held below 300 billions.

Bank loans are not the only inflationary factor in the present situation. Money in circulation, which stood at 6.5 billions in January, 1938, had increased to 26 billions in May, 1945. On the other hand, consumer credit decreased from 10 billions in 1941 to less than 5 billions in 1945.

Regulating the economy in wartime

Unable, because of widespread opposition on the part of the people, to tax heavily enough to prevent price inflation, and unable to drain off enough civilian purchasing power through the sale of bonds, the government late in 1942 adopted a three-pronged program for controlling prices and apportioning consumers' goods. This program called for (1) regulation of retail prices, (2) rationing of scarce goods, and (3) subsidies to a very few producers.

Price control. Any artificial regulation of prices of course means a partial abandonment of the price system, and that always brings infinite complications. It is in a sense a policy of sitting on the lid of the kettle when it is inexpedient to turn out the fire under it; yet price control is necessary. If too much purchasing power is left in the hands of consumers and the government depends on the price system to determine the prices of essential commodities, some prices will rise to a point where only the rich can buy them. If the government had left the distribution of gasoline to the action of a free market, the price would have soared, the rich would have been able to buy all they wanted, and people with modest incomes would have had to do without it. Such a policy would inevitably have aroused public resentment at a time when unity was most needed.

The problem of keeping prices under control was put in the hands of the Office of Price Administration, which was empowered to set ceiling prices on retail commodities, the prices chosen being those prevailing on a certain date, generally late 1942. Such a program involves many difficulties of administration. Inevitably conditions in the production of different commodities change; yet the OPA had to be careful in granting price increases lest it presently be buried under an avalanche of similar demands, many of them backed by powerful political blocs. Moreover, as costs of raw materials and labor rise, fixed retail prices impose a hardship on retailers and some manufacturers. Many manufacturers met this difficulty by cheapening the quality of their products. The quality of clothing, shoes, and many foods declined considerably after price control was instituted; an average shoe in 1945 was estimated to give 30 per cent less wear than a 1941 shoe, which means practically a 42 per cent increase in price. Clothing manufacturers cut corners wherever possible; many clothes had skimpy seams or were made of cheap material. In some cases goods were "upgraded," and the poorer grades sold at prices formerly charged for the better grades; thus dresses which formerly sold for $1.98 brought as much as $3.98 under price control. The best grade of butter, the "93-score" butter, once constituted only about 10 per cent of the total supply; in 1945 90 per cent of the butter was said to be sold as "93-score."

Such practices as these would not have been possible if some effective system of grading and labeling of goods had been enforced; but Congress not only would not provide for that but it actually relaxed certain of the few already existing provisions.

Rationing. In the chapters on price we saw that any government-imposed price below the equilibrium price results in an excess in the amount demanded over the amount supplied. Since price control naturally had this result, the OPA, in order to hold down the demand, instituted a system of rationing, whereby the purchase of certain commodities was restricted. A ration book containing stamps was issued to each individual, and the proper number of stamps had to be given the dealer whenever any of the rationed commodities were purchased. This amounted, practically, to the creation of another form of money, the supply of which was limited by the OPA and distributed equally among consumers. The point values of the various commodities were changed from time to time in accordance with fluctuations in the available market supplies of those commodities. For instance, when the supply of certain kinds of cheese was tight, the point value was raised; when the supply became ample, cheese was sold point free; but when the supply dropped again, it went back on the ration list and the point value was raised. Housewives had to make up ration calendars in order to keep track of the time limits on the various stamps and the changes in the point values. The OPA borrowed an ingenious scheme from the British experience in making one type of stamp valid for the purchase of several commodities. Red stamps were used for meats, butter, cheese, and other fats; blue stamps for canned goods; airplane stamps for shoes, and so on. This gave the consumer some choice and so enabled him to meet his own preferences to some extent, and it made it possible for the OPA, by raising the point requirements, to shift the demand away from the scarcer to the more plentiful goods.

Although rationing seems a fair way of distributing definitely scarce goods, the OPA encountered many difficulties, the worst of which was the "black markets"—secret and illegal markets where rationed goods were sold, usually at high prices but without stamps. Black markets sprang up in meat, gasoline, radios, and a number of other commodities. That in gasoline reached scandalous proportions. In some cases service stations sold gasoline without demanding coupons, and in other cases black market operators printed counterfeit gasoline coupons, some of which sold for as much as 50 cents a gallon. A black market even appeared in railroad reservations, for speculators brought up reservations in advance and sold them to passengers, sometimes with the connivance of railroad agents, at profits running as high as $50. In some cases rationing was evaded quite legally, as when families ate at restaurants some of the time and so increased their meat rations. It is difficult to see how this could have been prevented. Black markets could have been largely stamped out if public opinion had been strongly and patriotically behind the rationing program, but it was only lukewarm. Heavy penalties might have had some effect, but this is doubtful, for black markets flourished in Germany under Hitler, in spite of the fact that their operators were liable to the death penalty.[5]

Subsidies. A third way of fighting inflation is through the use of subsidies. When the government for some reason desired to prevent price increases but the necessary supply was not forthcoming because of the price ceilings, subsidies were given either to all producers, as in the case of meats, flour, butter, and milk, or to the high-cost producers only, as in the case of copper and crude oil. Subsidies do not provide a generally effective way of fighting inflation. If the government allows prices to rise, *consumers* will pay for the increase, whereas if it holds prices stable and subsidizes producers, *taxpayers* will pay it; the cost is approximately the same in either case. Yet there may be fairly good reasons for using subsidies. In the first place, price increases put a burden on all consumers, some of whom may not be earning high wages or may even have lost much or all of their income because of the war. For them, subsidies are obviously fairer than price increases. In the second place, it may be wise to keep prices of certain commodities down, in the interests of health or morale. Milk is essential to health, particularly for babies and children; and the government may be justified in using a subsidy to keep its price within the reach of all, and its supply adequate. In the third place, where a commodity is a highly important element in the cost of other commodities, any increase in its price is likely to be "pyramided" in successive markups until consumers are paying much more than the original increase. A subsidy may be justified to avoid this. In the fourth place, and far more important, when price ceilings are set and a few of them prove too low to bring out the necessary supplies, subsidizing the producers of those few commodities is less likely to create a widespread demand for higher prices than would raising the established price ceiling. Like price ceilings and rationing, however, subsidies are a poor substitute for taxes stiff enough to soak up excess purchasing power.[6]

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[5] For descriptions of American black markets, see *Saturday Evening Post,* July 25, 1942, p. 22; and *PM,* August 29, 1944, p. 13, and September 11, 1944, p. 14.

In summary, it must be said that the OPA did a fairly effective job in price control, in spite of all the difficulties put in its way by Congress and by the farmers and businessmen and other inflationary interests, and in spite of the difficulties inherent in the task of price control—or perhaps we should say in spite of the impossibility of doing such a job well.

The capitalist spirit in war

Our consideration of the problems of taxation, inflation, and price control brings out one of the disadvantages under which a capitalist society must work in fighting total war. Not only is capitalism more democratic than Fascism, less highly centralized and autocratic in its political structure and functions and therefore less easily converted to war, but its motivation is such as to make war difficult both to prosecute and to finance. In a Fascist country, war is held up as the highest form of activity, and people are accustomed to make sacrifices for the state; but in a capitalist society people are assumed to be motivated by the desire for profits, and there is no profit to be made in paying taxes, no profit to the people as a whole from a national catastrophe like war. Steeped in the philosophy of acquisition, accustomed to seek financial gain, they try to evade the hard necessities of war finance. To wage total war successfully and pay for it in such a way that they know they are paying for it—by taxation—people who have followed the lure of the dollar all their lives must forget about dollars and personal enrichment and the pleasures of good living; many will have to see their own fortunes dwindle and their factories, stores, farms, and homes depreciate while the labor and productive capital that once maintained them is devoted to war production.

Inevitably many people do not change their aims, but continue to seek personal gain in what can be only a general disaster. Most classes clamor greedily for an enlarged share of the diminished total. Businessmen in war production demand and usually receive generous and in some cases princely profits, for the tacit assumption is that otherwise they will refuse to aid the war effort. Farmers resist all efforts to control the prices of their products and demand higher incomes than they received in peacetime. Laborers demand and are paid better wages than ever; and contract agents, leeches, and grafters try to chisel fees and commissions and percentages on anything and everything. The soldiers and sailors and aviators who bear the real hardships and risks of battle must be content with merely nominal incomes; their reward is glory—while the home folks make the money. Let a measure calling for heavier taxation be introduced, and every economic class is up in arms immediately. The rich want a heavy sales tax so that the burden will fall on the masses, the poor want to "soak the rich" through heavier income taxes, bondholders protest against taxes on bonds—everybody wants someone else to pay the taxes. A profit-motivated society at war does not present a pretty picture. It suggests Ben Marsh's definition of democracy: "Democracy is the art of trying to pass the buck to Providence and the bill to posterity while living off the next generation." *Trying* to do these things, of course, and we *can* pass the buck to Providence; but the other things we cannot do.

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[6] For a careful analysis of the subsidies problem, see an article by J. P. Watson in the *Pittsburgh Business Review*, August, 1943.

Postwar problems: international relations

When the news came that Japan had surrendered, there was much blowing of whistles and honking of horns, much hilarity over the ending of the war, yet less than there had been at the end of World War I. This time many people, to their great credit, seemed to find their happiness diluted with a feeling of uncertainty, perplexity, or even helplessness, a feeling that the end of the war did not necessarily mean the establishment of a lasting peace, that the work of insuring the peace was only well begun.

In formulating international policies, the United Nations are confronted by two divergent possibilities. They can try to rebuild the world along the old imperialist pattern, restoring the status quo with respect to colonies and other territory, except for what is taken from the defeated Axis powers, and reestablishing wherever possible the old landed and industrial aristocracies that ruled before the war. Or they can try to establish real democracy with respect to colonies and international relations and to the internal government of both the liberated and the defeated nations. Let us see what each of these possibilities means.

An imperialist peace. An imperialist peace would mean that Great Britain would retain her present colonies, including India, Burma, and Malaya, her control over the Mediterranean area—Egypt, Greece, much of the Near East, and the Suez Canal—and at least part of her imperial rights in China, perhaps Shanghai and Hong Kong. Moreover, her empire would be enlarged by the lands taken over from the Axis, including a lion's share of Italy's African colonies. France would presumably recover all or most of her former colonies but would receive no large share of the Axis colonial spoils because she was forced to abandon the war soon after it began. The Netherlands would recover her rich East Indian possessions, Belgium would retain her African colonies, and China might be freed from some but not all of Britain's imperialist claims. In Europe, Poland has already been given most of East Prussia but has ceded part of the Ukraine to Russia. The U.S.S.R. has already taken the Baltic provinces of Latvia, Estonia, and Lithuania, and a small but valuable slice of Finland; she has already assumed a measure of control over the Balkan states, except Greece; and she is likely to demand certain rights in the Dardanelles which would give her access to the Mediterranean Sea. Great Britain would of course object to this last, as she has for a hundred years; but Soviet Russia may be strong enough to take pretty much what she wants. In an imperialist peace, Europe would be divided up into spheres of influence, each dominated by one of the victor nations; in fact, she is being so divided. The United States will not want colonies but is likely to retain air bases over much of the world, and control over a great deal of the Pacific area. Our vaulting ambition is well indicated by our present occupation of part of Korea.

As to the internal administration of the defeated nations, an imperialist peace would provide, at least as far as the Soviet Union permits, for regimes similar to those that existed before the war, or in some cases definitely Fascist regimes. In Germany the big landowners and industrialists would not be dispossessed, and the socialists and communists would not be given much power by occupation authorities. In the part of Germany occupied by Russia, this sort of dispensation has already been thrown overboard, for Soviet Russia has been breaking up big landed estates and expropriating the wealthy industrialists. She has done this not only in Germany but in Austria and some of the Balkan states. In Japan, an imperialist peace would maintain Hirohito on the throne, and would try to suppress any radical uprising of the people.

Some of the liberated countries would be similarly provided with conservative or quasi-Fascist regimes—such as that of Greece, for instance. France might again be delivered over to the industrialists who helped sell her out to Hitler. In the Netherlands and Belgium the big industrialists would reopen for business at the old stand.

The final provision of an imperialist peace would be the retention and possibly even the extension of the network of tariffs that have strangled world trade in the recent past. The same forces that would be able to prevent the democratization of the economy would be able to secure the tariffs that would be to their advantage. Each nation would try to become more and more independent of foreign trade, and the result would be the lowering of the standard of living in most countries.

What is the matter with such a peace? In the first place, it would mean continued resentment on the part of the colonies, and of the masses of the people in Europe. For some decades there has been throughout the world a rising tide of insurgence among the disfranchised colonials and among the propertyless workers in capitalist countries, a demand for a better status, more of the good things of life. Before the war this demand was met by various compromises—in the United States, by the New Deal. But it will be more insistent now, and it will be backed by a greater proportion of the people, for the ravages of war have left many former members of the middle class without property and without their former loyalty to business overlords. Few of them will return willingly to the status quo. In the second place, such a peace would have to be maintained by an alliance of the victorious powers; and such alliances have never endured for long. Such an alliance would be particularly hard to maintain because it would include Soviet Russia, and the powerful capitalist nations have long made a religion of hating communism.

Another objection to an imperialist peace is that it would inevitably lay the kindling for the Third World War. It would not meet the needs and aspirations of the peoples of the world. A return to the status quo would be a return to the conditions which spawned Mussolini and Hitler and which would spawn other Mussolinis and Hitlers.

A democratic peace. What are the general outlines of a healing, democratic peace? To draw up any comprehensive plan would be beyond the proper scope of this book, but a few suggestions will be offered. A democratic peace must recognize that colonies are not mere pawns in the chess games of selfish imperialist powers, that the peoples of India and Sumatra and Java and Libya and the Congo are not agricultural and industrial peons to be exploited for the enrichment of European financiers and industrialists. It must recognize that European workers are not industrial cannon fodder to be used for the enrichment of cartel owners and operators.

In international relations, a democratic peace would abolish economic imperialism, and substitute freedom for certain colonial dependencies—India, for instance. If such colonies as the East Indies and most of those in Africa are considered not yet ready for self-government, it would release them from the domination of European powers and would place them under an international commission which would manage their affairs for the benefit of their own people rather than the enrichment of foreign investors.

A healing peace would provide more rather than less democracy in both the defeated and the liberated nations. In Germany, for instance, it would necessarily mean socialization of the great cartels, expropriation of the Junkers and of the wealthy industrialists who financed Hitler's rise to power, and division of the great landed estates among small farmers. This would eliminate the powers largely responsible for German militarism. A similar policy would be applied in Japan, Italy, France, Poland, and the Balkan States. In China, it would mean the reversal of the Fascist policies of Chiang Kai-shek. Such a democratic policy would serve notice to all the peoples of the world that the Four Freedoms are living principles and not political buncombe.

Finally, a democratic peace would call for a world-wide and drastic reduction of tariffs. Since tariff making is one form of waging war, it might have to be put under international control. This would give producers throughout the world assurance that the export industries they build up would not be exposed to the danger that sudden changes in tariff policies in other countries might ruin their foreign markets; and it would raise the standard of living over all the world, which would in itself promote peace and good will, for, as Shakespeare observed, fat people are less likely than lean to stir up trouble.

Attractive as such a peace is to people of democratic sympathies, it seems unlikely to be realized fully. Up to the present time, the foreign policies of Great Britain and the United States have been generally hostile to democracy or even favorable to Fascism. Yet there are hopeful factors in the situation. The new socialist government of Great Britain may turn away from imperialism to some extent, may even support democratic forces in other countries, if it is not overthrown by powerful capitalist forces at home and abroad. The Soviet Union has already strengthened democratic elements in some of the countries under her influence—the Balkan States, for instance —but whether Soviet influence will be good in the long run we cannot tell.

The development of the atomic bomb has raised perturbing problems in international relations. As a decisive factor in the defeat of Japan the bomb was greeted with joy, but it is not certain that it will help to preserve the peace, not certain even that it may not be the means of destroying civilization itself. Immeasurably destructive, even in its present stage of development, it will be improved; and there can be no assurance that the human race can be trusted with so destructive a force. As long as the United States alone can produce the bomb, it will vastly strengthen our power in international affairs; and since our foreign policy has usually been anti-democratic, this means that it will strengthen the reactionary forces in the world which were already too strong. But other nations will learn to make the bomb, and then war may mean the obliteration of cities everywhere. Will we be forced to retreat to the caves from which prehistoric man ventured many thousands of years ago? That seems to be the prospect unless we can assure world peace. The atomic bomb presents the strongest argument for peace that has appeared in a century, but it offers no assurance that there will be peace.

Immediate postwar adjustments at home

It will take several years to get back to a peacetime economy. Some of our soldiers are already coming home; some will remain abroad as armies of occupation; the others will be brought home as quickly as possible—perhaps a two-year job. Millions of people are going back home to the civilian jobs they left when war broke out; a million new homes will be needed for them and for others, and a million or so that were hastily put up in war production centers will be scrapped. War contracts of some 22 billions are already being terminated; an estimated 50 to 100 billion dollars' worth of surplus property of various kinds—war plants, land (14,000,000 acres), shipping, trucks, jeeps, airplanes, and stockpiles of raw material, among other things—will have to be disposed of; factories will have to retool for civilian production, indeed are already doing so. To add to our domestic troubles, hundreds of millions of hungry, ill-clothed, ill-housed people in Europe and Asia will need food and clothing and shelter, and we should help them for a year or two.

Our fiscal situation will be very difficult. Our national debt will be staggering—at least 300 billions. Federal expenses for many years in the future will remain far above the prewar level—perhaps as high as 30 billions, which is four times the level of ten years ago. The soldiers must be brought home and put back in civilian jobs, those who are not disabled; and disabled veterans must be cared for generously. We have an immense navy of some 1500 combat vessels—greater than the combined fleets of all the other countries in the world—and its maintenance will be very expensive, for it will require expensive naval stations scattered over much of the world, and a personnel of some 2,000,000 men. We have a huge fleet of war planes, some of which will be retained for defense; and for them we must have airfields throughout the Pacific area and elsewhere. The army will be kept above its prewar strength.

The country is out at the heel in a thousand ways. Homes and apartments, business buildings, factories, streets and highways, railroads and railroad equipment—except that which was used largely for hauling war materials—are in a state of more or less disrepair or dilapidation. Furnaces, refrigerators, radios, vacuum cleaners, stoves, and other household furnishings are old and worn out. Automobiles are likewise old, and tires are ready for the scrap heap; the country needs about 16,000,000 new cars and 75,000,000 new tires.

Business analysts often point to such shortages as a favorable condition in the immediate postwar period. They assume that because of the severe shortage of most commodities the domestic market will be strong for several years, since the people will have, in war bonds or other savings, the financial means of buying freely.

The First World War was followed by two years of wild prosperity, and this may well occur again; moreover, it may last even longer because the shortages are more acute. It is one of the paradoxes of capitalism that if the people are sufficiently impoverished they may have business prosperity.

Long-run postwar problems

Some time in the relatively near future, if capitalism has not suddenly and completely changed its spots, there will be a depression, perhaps even more severe than the depression of 1929–1939, unless the government takes bold and energetic steps to head it off. Our national debt will be nearly ten times as high as the debt that looked so formidable at the end of World War I, and taxes will be high. The productivity of industry has increased so much that with output only as high as it was at our prewar peak (1929) 15 to 20 million people will be unemployed, which means that we shall have to produce much more than ever before and that consumers must be able to buy much more. After the wartime savings have been spent, we shall again face the old problem of distributing enough purchasing power among consumers to keep industry operating. We could not do this during the ten years before the war, and there is little reason to believe that, with all the accumulated burdens and maladjustments of the postwar period, we shall be entirely successful in the coming years. Since a depression, once well under way, may well develop into a widespread catastrophe, the government will use every possible means —including, no doubt, some measures that may be unwise—to prevent it from gaining headway. Economists and government officials are already working on plans for public works, public housing, reforestation, and land reclamation, to be put into operation at the first sign of a recession. Such a situation puts the government between the devil and the deep blue sea. If it allows a recession to gain momentum, the ensuing depression is likely to be so severe as to jar the very foundations of our economic order; and if it resorts to further borrowing to provide employment, it will increase the already fantastic burden of public debt. Facing such a situation, it may well undertake some public works projects, but with such timidity as to fail in its objective of providing full employment—as in the pump-priming efforts of the 'thirties.

The debt. A host of other economic problems will have to be faced. There is the federal debt, in the first place. What shall we do about it? Three alternative courses are open to us. We may try to pay it off, we may leave it as it is and pay only the interest on it, or we may try to reduce the burden of it by inflating the price level and thus repudiating it in part. To pay it off as rapidly as possible would be deflationary, because it would involve canceling the bank deposits which were created for the loans to the government. It would also require extremely heavy taxes, probably heavier than could be paid without generating a recession. We may assume, therefore, that there will be no vigorous policy of debt payment, and that we shall follow the second policy, of paying only the interest on the debt. If, however, we are obliged to increase the debt greatly because we are continuously unable to balance the budget, we may resort to the third policy, inflation. The government could save most of the interest on its bank loans—several billion dollars a year—by borrowing from its own banks, the Federal Reserve banks, and paying off the bonds held by private banks, but the opposition of the banks would doubtless make this impossible. The debt, like the poor, we will "have with us always."

Taxation. With government expenses running at high levels for the indefinite future, the problem of taxation will perennially plague us. If we are to avoid a spiral of federal deficits and inflation, we must tax heavily; yet taxes probably will have to be reduced, and the entire tax system revised, if business is to be encouraged. Various tax experts are already working on the revision of our tax system to encourage industry. Harold Groves, one of the most competent of these, has suggested a number of changes designed for this purpose, among them being the following:

1. Combine corporate and personal income taxes, and reduce the corporate income tax

drastically and the personal income tax moderately.

2. Repeal the excess profits tax so that businessmen will be willing to go into untried fields of production. We have already seen that this tax takes most of the profits above a certain level and thus discourages risky undertakings. If such ventures yield profits, the government takes most of them, and if they lead to losses, the entrepreneurs suffer. Such a tax offers no encouragement to venture capital.

3. Revise the personal income tax to make it more equitable and to plug evasion loopholes.

4. Retain but revamp the death tax.

5. Avoid federal sales taxes.[7]

Labor problems. It is doubtful if any conceivable revision of the tax system will keep industry operating at full capacity to provide full employment for labor. The same monopolies that have restricted production in the past are still in operation, and their power has grown during the war, as small business has declined. Furthermore, a capitalist economy must operate by fits and starts, and efforts to make it function steadily at full capacity may well create new difficulties for business enterprise, as the New Deal did. Yet influential politicians, and even a few leading businessmen, have promised full employment; and many people will be content with nothing less.

Other labor problems are likely to be more serious than ever before. Union officials report union membership at some 14 millions, by far the highest in our history; and these laborers have had steady work at high wages during the war. Unless the price level rises considerably, some wages will have to be scaled down if employers are to operate profitably; but labor, perhaps with the support of the government, will fight any proposals for wage reduction. Wages of some other types of labor have been frozen too low, and there will be determined efforts to get them up. Labor and capital are already gathering their forces for war, and in that war anything can happen.

International trade and tariffs. Critically important will be the problem of reviving international trade. The United States will have surpluses of some products which she must sell abroad if they are to bring remunerative prices; and most other countries must produce export surpluses of some commodities if they are to prosper. Great Britain particularly must build up a tremendous volume of foreign trade if she is to maintain even her prewar standard of living. She has lost most of her foreign credits and has incurred debts amounting to many billions; the annual interest payments alone would call for heavy exports of goods. Our own situation is not so critical, but if we are to dispose of our surpluses and receive interest on our loans abroad—in goods, of course—our tariff policy, and the policies of other countries, must be drastically revised. The economic health of the world demands this, but up to the present there has been little evidence of public interest in tariff reduction. Polls of public opinion may show growing popular intelligence on most questions, but the tariff remains a blind spot in the public eye.

Investments abroad. Already business leaders are planning to invest what they call our "surplus" capital abroad, in the devastated countries for rehabilitation, and in backward and undeveloped nations and colonies for industrial development. It is doubtful, however, if such investments will in the long run contribute either to the prosperity of the United States or to the peace of the world. We should help the devastated nations as much as is necessary to enable them to restore reasonable living standards, for hungry people are unlikely to be peaceful; but we should now know that foreign investments, made for strictly business purposes, whether in impoverished and devastated countries or in backward nations and colonies, often cause international friction. Our loans to European nations during and after World War I brought us the reputation of being an international Shylock; our investments in those countries, such as the Ford plant in Germany, involved unfortunate complications even before World War II; and investments in undeveloped countries and colonies are usually the prelude to imperialist policies which cannot contribute to world peace. Furthermore, such investments should rationally be made with the aim of receiving some future return on them, in goods; and of course we maintain tariffs for the specific purpose of shutting out goods. And finally, we have no surplus capital in the sense that we have more than is needed to produce the goods our people need.

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[7] Harold M. Groves, *Production, Jobs and Taxes.*

Monetary plans. Tariff reduction should be accompanied by the creation of an efficient and satisfactory world monetary system. The war wrecked the monetary systems of a great many countries, and inflation in varying degrees of virulence stalks across almost every land. Before there can be any economic health in such countries as China, Japan, India, France, Italy, and Greece, a new and stable monetary system must be set up. British and American monetary experts have been working on the problem of a world monetary system, and it is possible that some progress may be made; however, the details of the present plans are too complicated to be presented here or to be understood by the people. In spite of their inability to understand so complicated a question, our people do not entertain the unfortunate preconceptions which prevent them from understanding the tariff issue; hence there is a chance that we shall be able to solve the monetary problem with some success. At least one thing is certain at this stage—whatever monetary system is proposed must be international in character.

International cartels. Most of the international cartels which hampered our efforts early in the war are still operating secretly and will continue to do so, perhaps will even expand their activities unless something is done about them. They were one of the means by which Hitler came near to world conquest, which means that no democratic government can be secure until they are brought under control; but the means of controlling them is not yet clearly evident. The abolition of international patents might achieve something; but a few authorities are of the opinion that nothing less than the abolition of all private patents, national as well as international, will solve the problem. The experts are not in entire agreement as to its solution; yet the people must tackle it as best they can.

Conservation of resources. The vast waste of war has left us, in a more acute form than ever before, the problem of the conservation of our resources, a problem that we shall have to face not for a few years but for all time. We have fed our timber, our irreplaceable iron and copper and lead ore, our coal and petroleum and natural gas, into war's greedy maw without stint; and the depleted reserves with which we are left must be conserved carefully if future generations are to have the essentials of a good life. If we cannot find ways of doing this, the future is indeed dark.

Conclusion

So, in these troubled postwar years we face many difficult economic problems. An intelligent citizenship might be able to solve them; but the carefree, happy-go-lucky days when problems could be solved by ignoring them are gone forever. No longer will the people be able to take their democratic liberties for granted; they must be defended against hostile forces within and without the country. We must read and study and debate; we must learn about the isms that threaten us, not from propaganda for or against, but from disinterested sources; we must maintain open minds on critical issues; we shall have to adopt new ideas, new attitudes, suited to the problems of a rapidly changing world. If we can and will do all these things, we may be able to preserve our democratic way of life. The task is difficult, but the issue involved is nothing less than the preservation of American democracy and of American civilization, for there can be no worth-while civilization without democracy. Let it not be said presently, in the words of Isaiah: "Therefore my people are gone into captivity, because they have no knowledge."

QUESTIONS

1. The Second World War was to some extent an imperialist war, but it had other important characteristics. What were they? What evidence is there that this war represented, or arose out of, a class struggle?
2. Explain the tremendous cost of this war, as compared with the costs of other wars.

3. Describe some of the methods used by the government in fixing prices for war supplies and equipment. Why are these prices usually very high?
4. What do you mean by "total war"? What is new about it?
5. If the government took by taxation the share of the national income that it needs for war purposes, could it depend on the operation of the price system to allot production between it and civilians and to distribute civilian goods among consumers, thus avoiding the difficulties of rationing? Why or why not?
6. Summarize briefly our government's labor policy during the war. Was it reasonably successful? Why or why not?
7. Discuss the relative status of laborers and farmers during the war. How did small business fare?
8. As a means of financing a war, compare borrowing from private banks, borrowing from government banks, and issuing paper money, as to inflationary effect, burden on the present generation, and burden on future generations.
9. Describe the rationing system used by the OPA. Why was the OPA unable to prevent black markets?
10. Where were subsidies used by the OPA during the war, and why?
11. Describe roughly a possible imperialist peace settlement. What would a democratic peace provide? Why does such a peace seen unlikely?
12. Why will our government expenses be high for some time to come?
13. Is a depression likely in the relatively near future? Another New Deal? How would we pay for another New Deal?
14. Why do we not dare to pay off the war debt?
15. What changes in our tax system have been suggested to stimulate postwar business?

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